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# SOVIET-EUROPEAN GAS PIPELINE

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## HEARING
BEFORE THE
## SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY
OF THE
## COMMITTEE ON FOREIGN RELATIONS
## UNITED STATES SENATE
NINETY-SEVENTH CONGRESS
SECOND SESSION
ON
UNITED STATES ASSERTION OF EXTRATERRITORIALITY WITH RESPECT TO THE SOVIET-EUROPEAN GAS PIPELINE

MARCH 3, 1982

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# SOVIET-EUROPEAN GAS PIPELINE

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WEDNESDAY, MARCH 3, 1982

United States Senate,
Subcommittee on International
Economic Policy of the
Committee on Foreign Relations,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 4221, Dirksen Senate Office Building, Hon. Charles McC. Mathias, Jr. (chairman of the subcommittee) presiding.

Present: Senators Percy and Mathias.

Senator Mathias. The subcommittee will come to order.

This morning the Subcommittee on International Economic Policy will examine one of the more complex and one of the potentially divisive issues surrounding the proposed Soviet-Western European natural gas pipeline.

U.S. policy regarding the pipeline has reached an important and a dangerous crossroads. The United States has tried to persuade Western European countries that in their own security and economic interests they should not proceed with the pipeline. We have backed up our position by refusing to issue licenses for American firms to sell equipment or technology for the pipeline. Despite our efforts, however, it is clear that the Europeans have decided to go ahead with the pipeline.

Contracts for equipment have been signed, deliveries of gas agreed upon, and financial arrangements have been concluded. The question now is whether or not the United States should attempt to extend its legal reach inside foreign jurisdictions for the purpose of stopping or delaying construction of the pipeline.

Administration witnesses have acknowledged that such measures were under consideration. Under Secretary of Commerce Lionel Olmer testified on February 5 before the Subcommittee on Investigations and Oversight of the House Committee on Science and Technology that the administration was studying whether or not to apply U.S. export controls extraterritorially to block the use of U.S. licensed technology in construction of the pipeline.

In further testimony, Deputy Assistant Secretary of Defense Stephen Bryen suggested that the United States might be able to delay the pipeline from 2 to 5 years if we could prevent European firms from using previously licensed U.S. rotor technology in turbines for gas compressor stations.

Now, as a former lawyer, whenever I hear the word "extraterritoriality," a small mental warning sign flashes, a red flag goes up, because any attempt by one country to apply its law outside of its own territory to the citizens of other countries certainly is too highly controversial. This has been true, as we have observed on another committee on which I sit, with respect to antitrust law and other areas of business regulation, including, of course, the steps taken in the Iranian assets case to reach deposits in U.S. banking branches and subsidiaries abroad.

Some of those present today may recall several years ago that the United States tried to prevent a Canadian subsidiary of a U.S. company from exporting buses to Cuba. In that case, and in many others, the United States got into sharp and ultimately futile conflicts with allied governments. The outcome damaged U.S. foreign policy and, I think, damaged U.S. economic interests as well.

For this reason, I believe that before making any decision, the Congress, the administration, and the American people should be fully aware of all the implications of an attempt to assert extraterritoriality.

The purpose of this hearing is to help focus thinking on the questions which an assertion of extraterritoriality would raise. To my mind, these questions fall into three broad categories. The first are the legal questions. What do current U.S. laws and regulations provide concerning extraterritoriality of U.S. export controls, particularly foreign policy controls? What specific actions could the U.S. Government take to enforce an assertion of extraterritoriality? What standing would U.S. actions have in foreign countries and in international law? What precedents are there for asserting extraterritoriality in this type of case?

There are also important political questions. How would our Western European allies and other friendly governments react to a U.S. assertion of extraterritoriality? What political strains would such actions create in United States-European relations? What would be the impact upon U.S. efforts to obtain European cooperation on a broader East-West economic plane, involving issues such as high technology, trade and credits?

Finally, there are what I believe to be serious economic questions. What would be the effect of an assertion of extraterritoriality on the reputation of American firms as reliable suppliers of goods, technology, and investment? Would U.S. firms find themselves increasingly isolated from world trade, especially trade in high technology which has been so important to us? Would we force the development of new competition to U.S. business by making a search for alternatives to U.S. suppliers necessary?

I hope that this morning's hearing will provide some of the answers to these questions. While I do not wish to prejudge the outcome of the hearing, I do want to make clear that I start from a point of deep concern about an assertion of extraterritoriality.

I have recently returned from Europe, in fact, a week ago today, where I spent some days attending meetings of the North Atlantic Assembly's Economic and Energy Committees, and consulting with West European leaders. I strongly urged them to look to American coal as an alternative to Soviet gas. However, based upon these discussions, I am convinced that the Europeans are determined to proceed with the pipeline and that the governments of Western Europe will not accept the unilateral application of U.S. export control regulations to their citizens and their economies, and any effort by the United States to apply unilateral foreign policy export controls extraterritorially very probably would be counterproductive.

I am sure on the basis of my conversations that it would result in an acrimonious and divisive dispute, and that in the long run it probably would not significantly hold up the pipeline. It might delay it a little, perhaps, but it would certainly not cancel it.

The aftermath of this dispute would damage the prospects for Western cooperation on other East-West economic issues, including the effort in COCOM to tighten multilateral controls on the exports of militarily critical goods and technologies to the Soviet bloc.

I also have to wonder whether a delay in the pipeline brought about by the United States at great political cost to us would hold up construction much beyond the point that it may be delayed for other reasons. As the Office of Technology Assessment has pointed out in its excellent study on Soviet energy, the West Siberian gas industry has been beset with problems. These problems, such as extreme weather conditions, planning failures, and lack of infrastructure, are likely to affect the gas pipeline as well, causing delays which will occur naturally without our intervention, without our lifting a finger, without our incurring any of the costs that I have been discussing.

Finally, I am deeply concerned about the impact an assertion of extraterritoriality would have on the reputation of U.S. firms as reliable suppliers. If we tried to assert extraterritorial control in this case, European and Japanese firms doing business with American firms will have to ask themselves whether their contractual arrangements will be subject to some unforeseen unilateral U.S. control in the future. This could very well result in lost markets for the United States throughout the world.

It certainly is ironic that at the very time we are warning the Western Europeans about the dangers of dependence on the Soviet Union as an unrealiable supplier, we may ourselves be proving to be unreliable.

We in Maryland who have a high regard for Henry of Navarre—who became King of France, known to the world as Henri IV—we have a high regard for him because the State of Maryland is named for his daughter, Henrietta Maria, but there is a story about how he came to be Henri IV, how he came to be King of France, because he was confronted by the need to change religion in order to unify France under his reign. He is reported to have said, "Paris is worth a mass."

Perhaps the time has come for another conversion, reluctant though we may be to make it. Maintaining the unity of the Western Alliance may be worth at least tolerating a pipeline.

Senator Percy?

The CHAIRMAN. Thank you very much, Mr. Chairman. Ordinarily, we hold a hearing and then form our judgments. In this kind of case, however, it would be almost hypocritical if we did not come into this with some convictions in this regard. I certainly had deep convictions when I came to the Senate 15 years ago, having served in a multinational corporation for 25 years and seeing the impractical effect that some of our governmental actions had. There is an old saying that you can shoot off your own foot. When I saw jobs deprived at a Chicago company because identical equipment, only with a change in nameplate, could be furnished readily to the Soviet

Union by the United Kingdom, we obtained a license fee for it which is a pittance compared to the absorption of direct labor, overhead, amortization of tooling costs, and research. It was just ludicrous.

I was on the Banking Committee then, Mr. Chairman, and worked very hard to get a change in the Export Control Act to the Export Administration Act, to put the simple provision in that if there is identical equipment or comparable equipment available from other places, unilateral sanctions by us are literally foolhardy. We look like fools when we do things like that. We are emotionally getting something out of our system. If we consider that a credible foreign policy depends on a strong national defense, that it is essential to have that, that it is essential to have a strong, growing, and dynamic economy, you know that you cannot have a weakened economy with one of the hungriest markets in the world cut off from us because literally identical substitute equipment is available from other sources.

In discussing this as we did last night with the Secretary, and I discussed it at the Department this morning, I indicated that I have strong feelings about this. I would like to insert into the record at this time, because I think the decision is going to be made very quickly now, the letter that I wrote to the President on February 25 indicating my very strong feelings about this particular issue of the pipeline.

[The letter referred to follows:]

UNITED STATES SENATE,
COMMITTEE ON FOREIGN RELATIONS,
*Washington, D.C., February 25, 1982.*

The PRESIDENT,
*The White House.*

DEAR MR. PRESIDENT: It is evident that most of our European allies remain more optimistic than we are about the realistic possibilities for promoting a stable and cooperative relationship with the Soviet Union. This view leads to a basically different European approach to arms control and economic sanctions. Poland is the case at hand, where despite the January 11, 1982 NATO ministerial communique, virtually all Europeans still support the Trans-Siberian gas pipeline and fully intend to see it to completion.

I recognize that the hard currency earnings and the economic leverage gained by the Soviets might be used to thwart U.S. interests in the future, but this must be balanced against the costs of trying to implement a set of restrictions aimed primarily at our allies and the fact that such restrictions would at best delay pipeline construction for about a year. Our European allies believe we have failed to identify concrete alternative energy supplies and are asking them to bear a disproportionate burden in sanctions against the Soviet Union. They would, therefore, retaliate with anger if the United States denied the required licenses for pipeline construction. While the United States must continue to emphasize the limitations of the détente policy, I am convinced that a coercive approach on the pipeline issue can only prove counter-productive. We must not allow the crisis of the East to trigger a crisis in the West.

Sincerely,

CHARLES H. PERCY,
*Chairman.*

The CHAIRMAN. Having been at a conference in Munich embracing all European countries, having talked to the representatives, defense ministers, et cetera, of every one of those countries, knowing of the absolute conviction that they have to go ahead with this Trans-Siberian pipeline, I must say that they have listened to us. They are well aware that they are vulnerable. They are well aware that the spigot of the pipeline could be turned off, but they are not going to allow themselves to get into a position of overdependence. They have decided that they have the soverign right to make this decision, and they will make it.

I therefore feel absolutely convinced of their going ahead with it, and that it would be counterproductive to have dissention and disunity in the Western Alliance over this particular point. We have made our point. They have listened to us. They are fine friends and allies, but they have decided that in their judgment on balance it is best for them to go ahead with this.

For us then to throw sand into the gears and think that we can really do that effectively in my judgment is just wrong. It would put us into a very difficult position. I think at this stage, having expressed ourselves, having pointed out our concerns, they, having responded, are taking these concerns into account, so we should not use whatever powers we have to counter this.

You, as a lawyer, Mr. Chairman——

Senator MATHIAS. A former lawyer.

The CHAIRMAN. Maybe so, but you are still a good lawyer. Certainly I as a former businessman, would say that this does not make good business, it doesn't make sense, and I think it would be counterproductive. I think the Soviets would rejoice if we made this decision to be so-called hard line. Why, the hard liners in the Soviet Union would enjoy seeing this divisiveness. They know it is going ahead anyway, and they know they can circumvent it. Maybe this will slow it down, but they are going to prove that they have the sovereign right to make this decision.

In an open society, maybe it is a little embarrassing for us to discuss this openly, but ours is an open society. We are having a hearing today. We have outstanding witnesses, and I would like the privilege of presenting one of those witnesses to the subcommittee. He is from Illinois. But the conclusion that I have come to on this issue is one of a matter of 15 years' record. It has been a steady and consistent position of mine.

Mr. Chairman, I think that this hearing is important, but I do feel that it is appropriate that we express our own prejudices or our own points of view and convictions which we have held for so long.

Also, I have a prepared statement which I would like incorporated in the record at this point which will amplify on my comments.

Senator MATHIAS. Without objection, it will be included at this point.

[Senator Percy's prepared statement follows:]

### PREPARED STATEMENT OF HON. CHARLES H. PERCY

Mr. Chairman, I am very pleased to be with you here today as you launch this hearing into a very important aspect of our international economic policy.

A decade ago our Government initiated a new era of trade with Eastern bloc countries. The basis of that policy was a belief that expanded trade with the Soviet Union would lead to improved diplomatic relations and a more stable world, both economically and politically.

Many businesses took the Government at its word and negotiated contracts with the Soviet Union. Trade did, indeed, increase, although not at the pace some observers had projected. American, European and Japanese businesses exported billions of dollars of equipment and grains to the Eastern bloc countries on the basis of this new policy.

In the last 2 years, Soviet intervention in Afghanistan and Poland has led our Government to change the thrust of this policy to one of active discouragement of many kinds of trade with the Soviets. It is inevitable that such a swing would cause economic dislocation in the United States, Europe and Japan, for thousands of jobs in each country were at stake. Yet there seemed to be little consideration of the domestic repercussions from the 1980 grain embargo and last year's sanctions. These considerations were overridden by the desire to act with our allies to punish the Soviets.

We found, however, that our allies did not share the same view as we did. Although the grain embargo did have an impact on the Soviet economy, it also led the Soviets to purchase large amounts of grain from Argentina, making that country, for the first time, a major supplier of grain to the U.S.S.R.

With the present sanctions, we unfortunately see a similar pattern: U.S. sanctions have not yet had the desired effectiveness because Europe and Japan have not fully joined us. To make such sanctions truly worthwhile we need that type of unified action. The Department of State agreed with that last December. Richard Fairbanks, then Assistant Secretary for Congressional Relations, wrote me that "a coordinated allied sanctions policy requires careful planning and consultation." He also said that "our conversations with repect to Poland have indicated a considerable degree of unity in allied thinking." I would like to insert his letter for the hearing record.

Unfortunately that unity has not materialized so far and our own companies bear the brunt of the sanctions. Once again there is a very substantial domestic cost of the sanctions.

Mr. Chairman, we need to be very careful when we impose sanctions. We should undertake them when there is a good chance of success. The same can be said of other trade actions with our allies. If our Government is considering the extraterritorial application of U.S. laws, there should be careful evaluations of the impact such an action would have on our NATO relations. A week ago German Economics Minister Otto Lambsdorff was in Washington and told us his views on this point: he warned that extraterrioriality would be a dangerous development for world trade. Our alliance is simply too important to attempt to apply our laws abroad when such an action will be strenuously opposed by Europe. We need a more thorough assessment of the effects of sanctions—certainly more thorough than given the impact on our own domestic economy.

Senator MATHAIS. Mr. Chairman, let me call to the witness table the first panel, Mr. Erskine C. Chapman, executive vice president of Caterpillar Tractor Co., who by chance comes from Peoria, Ill., and Mr. Arthur T. Downey, who will be appearing on behalf of the U.S. Chamber of Commerce.

The CHAIRMAN. May I just say, Mr. Chairman, that Mr. Chapman is very well qualified to appear as a witness this morning. Caterpillar is not only the largest manufacturer in the State of Illinios, but it is a company which has an unusual management attitude. I think most companies have a very strong feeling of patriotism, but here is a company headed by Lee Morgan, one of the most respected industrialists in America for years, and David Packard, former Deputy Secretary of Defense, is on that board. I have met with that board and have talked about these issues with that board.

Certainly, if it is in the national interest, I do not know of any company which would not willingly subordinate its company interest to the national interest, but I think in this case the feeling is quite strong that the overriding and overshadowing interest is in the reliability of the United States as a supplier to the world.

We know, for instance, what it cost us, and we have all supported freezing the assets of Iran, but we know now as we knew then that it would cost us something, but even in that overwhelming case where the whole world was with us, except Iran, $48 billion had not come to this country which would have been or could have been deposited because of a little concern on the part of other countries which felt they might at some time have a political difference with the United States and feared that this might happen to them.

I can just imagine what happens when we embargo anything, put sanctions on anything, what happens to the whole product line all over the world. Any country wonders if they will be deprived of spare parts, and have equipment that doesn't function, as we have all over Poland today. Should they buy American or should we buy Japanese, German, Italian, British instead? I don't know anyone better qualified to address this subject than a man who has spent three or more decades with this company, starting out as a sales trainee, and went through the whole marketing management situation, and now is executive vice president.

We strongly welcome Mr. Chapman as a witness today. Mr. Downey, we are also very pleased to welcome you.

Senator MATHIAS. Mr. Chapman, please proceed.

## TESTIMONY OF ERSKINE C. CHAPMAN, EXECUTIVE VICE PRESIDENT, CATERPILLAR TRACTOR CO., PEORIA, ILL.

Mr. CHAPMAN. Thank you, Mr. Chairman.

Mr. Chairman, Senator Mathias, it is a privilege for me to be here before this subcommittee today. I only wish it were a happier story that I had to tell.

I am E. C. Chapman, executive vice president of Caterpillar Tractor Co. I have submitted to the subcommittee a statement of my views, which I would like to have included in the record of this hearing. I will summarize my statement.

Senator MATHIAS. Your full statement will, without objection, be inserted in the record.

Mr. CHAPMAN. Thank you, Mr. Chairman.

In your letter of invitation, you asked that I focus on the impact of U.S. foreign policy controls on the reputation of U.S. firms as reliable suppliers. I am pleased to do so, using my company's recent experience as an example, and I will start with the conclusion. Unilateral sanctions imposed on U.S. exports involving internationally available goods and intended to influence the course of events abroad just do not work.

This morning, your hearing is focused on controls against the Soviet Union, and the references I will make will be to our Soviet experience. From administration after administration, we hear that unilateral export controls do no good, and that before the United States will take action our Government will consult with and be sure our allies will support us. Then, as the latest international trouble spot heats up, economic sanctions emerge. Only then, it seems, do we go out and solicit our allies' help. All too often they view the present crisis differently than we do and decline to participate fully, if at all, in the proposed embargo.

As you well know, Caterpillar has been directly impacted by the sanctions President Reagan imposed against the Soviets in late December. We believe our case related to export control on pipelayers is a graphic illustration of this problem.

Let us look at what has happened to our sales and those of Komatsu, our major Japanese rival, sales to the Soviet Union since mid-1978. That is when the Carter administration first placed export controls on oil and natural gas equipment, including pipelayers, in response to Soviet violations of our human rights standards. The numbers on the chart in my statement represent Soviet purchases of large track-type tractors and pipelayers. In the time frame of 1970 to mid-1978, the Soviets purchased 1,943 Caterpillar units. In the same time period, they purchased 341 Komatsu units. Since mid-1978, since the first imposition of export controls on pipelayers, through 1981, the Soviets have purchased only 336 Caterpillar units and 1,997 units of Komatsu product.

The striking point about the figures and the table is that before mid-1978, Caterpillar dominated the Soviet market for large machines supplying 85 percent of the demand. Since the imposition of the Carter sanctions, the turnabout has been dramatic. Komatsu has held an 85-percent share of a rapidly growing market.

Had we maintained the share of the business we held before the Carter sanctions, and that, of course, is always subject to our being able to remain the preferred competitor, as much as $400 million of additional U.S. exports and 12,000 man-years of employment at Caterpillar and its suppliers could have been generated. Follow-up sales of replacement parts would probably have added another 25 percent.

Following the Carter sanctions, we worked hard to reestablish our once-leading position in the Soviet market. We were on the verge, we believe, of breathing new life into our once strong, reliable supplier relationship. In July, after having made application in February, 5 months earlier, we were granted a license to export 100 pipelayers to the U.S.S.R. In early December, three months after making application, we were given Presidential approval to export 200 more machines.

That latter decision was overturned when in late December the President imposed sanctions against the Soviets, and those sanctions effectively undercut any progress we had made.

We can identify a number of direct impacts on Caterpillar of the recent sanctions. First is the loss of the sale of 200 pipelayers with a license value of about $90 million. Very promising discussions that were under way with the Soviets for sales of additional large quantities of pipelayers have had to be abandoned.

Second, potentially the sanctions will block or reduce other sales that were not intended to be affected. Typically, contractors desire commonality of equipment at a job site. Thus, use of Caterpillar pipelayers would normally dictate the use of our track-type tractors and other related equipment.

Third, writing off a large share of the Soviet market will affect our price competitiveness internationally. For example, recent Soviet commitments to buy 1,500 large Komatsu machines represents a very large order for that size equipment. The ability to spread their costs over that quantity of business improves Komatsu's already strong position vis-a-vis Caterpillar.

And fourth, seriously in jeopardy throughout the world is the reputation of Caterpillar and other U.S. firms as reliable suppliers. This situation affects adversely our ability to compete in the world marketplace. It forces potential buyers to question whether we will be able to maintain a long-term relationship and thus leads buyers in other directions.

Particularly important in this regard is the present ban on the export of replacement parts for pipelayers previously sold to the

Soviets. The ban can irritate and inconvenience the Soviets sufficiently that they will likely avoid future purchases of Caterpillar and other U.S. products, but such a ban will not inflict the kind of serious penalty that might bring about a change in Soviet policies.

The impact of this loss of present and potential business would be painful in any circumstances, but it is made doubly so by the economic slump Caterpillar presently faces. The news is a bitter pill to the thousands of company workers presently on layoff. We could better understand the need for such sacrifice if it were clearly linked to offsetting gains for the United States. Unfortunately, the history of unilateral trade sanctions suggest it is unlikey there will be any such gains.

Mr. Chairman, I have raised a number of times the question of these controls being applied unilaterally, and I think you deserve some elaboration on that point. A story in last week's Washington Post provides striking evidence of the situation. The headline of that article said, and I quote, "Japan Imposes Sanctions Against Soviets and Poles." End of quote. But what the story said, as it related to Caterpillar, is that Tokyo has confirmed the sale of 900 pipelayers by the Japanese.

Well, we already knew that, and we told the U.S. Government that in mid-December, before the sanctions were imposed, but the information apparently carried little weight when the sanctions decision was made. It is true that the Komatsu commitment to the Soviets was made before the declaration of martial law in Poland, but so was Caterpillar's. The Japanese Government's response is apparently that a deal was made and they can't renege on it. Washington's response seemed to be that commercial interests must take a back seat to the symbolic expression of our dissatisfaction with the Polish situation.

We keep hearing from Tokyo that the Japanese won't do anything to undermine the sanctions, and we hear from our own State Department that the continuing revelations of Komatsu sales don't violate that Japanese commitment. I am appalled that we allow such a charade to persist. Komatsu's contracts predated the imposition of martial law, but the Komatsu deliveries will be made in 1982, long after the announcement of sanctions. Though Tokyo announced that it would do nothing to undermine the sanctions, the Japanese Government has added parenthetically that their existing commitments would be honored.

In contrast, Caterpillar's experience was that 3 weeks after the President agreed to approve our license, the license had not yet been issued, and our sale was lost in the sanctions. It is a fine position for Komatsu, being helped by actions from both the Japanese and United States Governments.

As far as pipelayers are concerned, the Japanese sales appear to significantly offset any benefit to be gained by the withholding of Caterpillar equipment.

Mr. Chairman, let me repeat my thanks for the invitation to appear here today. I know this is a delicate and controversial subject, and it is important that all perspectives be heard. It is especially important, I think, that U.S. commercial interests not be simply set aside when other problems press in on our country.

I appreciate having had the opportunity to present that point of view, and I look forward to responding to your questions later. Thank you.

[Mr. Chapman's prepared statement follows:]

### PREPARED STATEMENT OF ERSKINE C. CHAPMAN

Thank you. It is a privilege for me to be before this Subcommittee today. I only wish it were a happier story I had to tell.

I am E. C. Chapman, Executive Vice President of Caterpillar Tractor Co. My intention this morning is to review with you our company's recent history related to export controls. I'll start with the conclusion:

Unilateral sanctions imposed on U.S exports, and intended to influence the course of events abroad, just don't work. In the context of this morning's specific discussion topic, I should add that I believe any effort to apply such controls in an extraterritorial manner will not lead to positive benefits for the United States.

This morning your hearing is focused on controls against the Soviet Union, and the references I'll make will be to our Soviet experience. But my comments are applicable to all economic sanctions. The business community is of one mind on this, and has expressed its view many times over the years: unilateral export controls on products available elsewhere simply don't work.

In Administration after Administration, irrespective of political persuasion, we hear rhetoric about the need for American companies to compete aggressively abroad. We hear that each of these Administrations realizes that unilateral controls will do no good; and that before the United States will take action, our government will consult with and be sure our Allies will support us. Then, as the latest international trouble spot heats up, the rhetoric changes. There is talk about possible economic sanctions, and then they are imposed. Only then, it seems, do we go out and solicit our Allies' help. All too often they view the present "crisis" differently than we do, and decline to participate fully—if at all—in the proposed embargo.

I'd like to share with the Committee some comments Caterpillar Chairman Lee Morgan recently communicated to President Reagan, in response to the imposition of sanctions against the U.S.S,R. in late December. Lee wrote:

"I share your deep regret over the international circumstances that have led to the imposition of economic sanctions. My purpose in writing is not to disagree with the objective or sending a signal to the Soviets concerning events in Poland. The economic sanctions imposed have gotten the attention of Soviet leaders.

"However, I have strong doubts about any lasting effectiveness of restrictions on U.S. exports. While the news that sanctions have been imposed has an undeniable short-term impact, the Soviets quickly turn from U.S. suppliers to competitors in other countries. From that point on, sanctions have little impact on the Soviets, who therefore have little reason to alter their behavior in response to them. But export controls have a continuing impact on American companies and their employees, who see sales and jobs transferred to other countries."

To use a now frequently referenced phrase, this amounts to nothing more than "shooting ourselves in the foot."

The recent Caterpillar experience with export controls on pipelayers is a graphic illustration of this problem. Let's look at what has happened to our sales and those of Komatsu (our major Japanese rival) to the Soviet Union since mid-1978. That is when the Carter Administration placed export controls on oil and natural gas equipment—including pipelayers—in response to Soviet violations of our human rights standards.

The numbers on this chart represent Soviet purchases of large track-type tractors and pipelayers. (While it is impossible to have precise data on sales by our competitors, we have a high degree of confidence in the figures I'm presenting you.)

| Time frame: | Units |
|---|---|
| 1970—mid-1978: | |
| Caterpillar | 1,943 |
| Komatsu | 341 |
| Mid-1978—1981: | |
| Caterpillar | 336 |
| Komatsu | 1,997 |

The striking point about this table is that before mid-1978, Caterpillar dominated the Soviet market for large machines, supplying 85 percent of the demand.

Since the imposition of the Carter sanctions, the turnabout has been dramatic—Komatsu has held an 85 percent share, of a rapidly growing market.

It is always difficult to know what motivation underlies specific Soviet purchasing decisions. But, had we maintained the share of the business we held before the Carter sanctions, as much as $400 million of additional U.S. exports and 12,000 man years of employment at Caterpillar and its suppliers could have been generated. Follow-up sales of replacement parts would probably have added another 25 percent (or $100 million in exports and 3,000 jobs). In view of the fact that the embargo does not appear to have seriously disadvantaged the U.S.S.R., this seems an expensive price to pay.

The Carter sanctions affected Caterpillar seriously, as I've shown. Nevertheless, we had worked hard over the past year or so to reestablish our once leading position in the Soviet market. We were on the verge of breathing new life into our once strong "reliable supplier" relationship. In July we were granted a license to export 100 pipelayers to the U.S.S.R. In early December we were given Presidential approval to export 200 more machines. That latter decision was overturned, when in late December, the President imposed sanctions against the Soviets. The present situation effectively undercuts any progress we had made.

We can identify a number of direct, though not in all cases measurable, impacts on Caterpillar of the sanctions that have been applied against us. First is the loss of the sale of 200 Model 594 pipelayers, with a license value of about $90 million. Very promising discussions that were underway with the Soviets for sales of additional large quantities of pipelayers have had to be abandoned.

Second, potentially the sanctions will block, or reduce, other sales that were not intended to be affected. Typically, contractors desire commonality of equipment at a job site. Thus, use of Caterpillar pipelayers would normally dictate use of our track-type tractors and other related equipment.

Third, writing off a large share of the Soviet market will affect our price competitiveness internationally. For example, the recent Soviet commitment to buy 1,500 large Komatsu machines represents a very large order for that size equipment. The ability to spread their costs over that quantity of business will improve Komatsu's already strong position vis-a-vis Caterpillar, as the two companies develop worldwide pricing structures for their larger machines. Komatsu's improved U.S.S.R. position will benefit their marketing effort worldwide, at our expense.

And fourth, seriously in jeopardy throughout the world is the reputation of Caterpillar and other U.S. firms as reliable suppliers. This situation affects adversely our ability to compete in the world marketplace. It forces potential buyers to question whether we'll be able to maintain a long-term relationship, and thus leads buyers in other directions.

Particularly important in this regard is the present ban on the export of replacement parts for pipelayers previously sold to the Soviets. The ban can irritate and inconvenience the Soviets sufficiently that they would likely avoid future purchases of Caterpillar and other U.S. products. But it would not inflict the kind of serious penalty that might bring about a change in Soviet policies. There are too many ways the Soviets can get parts besides buying them directly from us. We fear that the parts export ban—though having little direct impact on the Soviets—will have a devastating effect on Caterpillar's reputation as a reliable supplier.

The impact of this loss of present and potential business would be painful in any circumstances. But it is made doubly so by the economic slump faced by Caterpillar and the communities in which we're located. We have already announced indefinite layoffs of over 7,000 employees; and tens of thousands more are affected by periodic shutdowns. In addition, there is a ripple effect that hits our suppliers at an estimated rate of two jobs for each Caterpillar job.

We could better understand the need for such sacrifice if it were clearly linked to offsetting gains for the United States as a whole. Unfortunately, the history of unilateral trade sanctions suggests it is unlikely there will be any such gains.

Mr. Chairman, I've raised a number of times the question of these controls being applied unilaterally, and I think you deserve some further comment on that point. A story in last week's Washington Post provides striking evidence of the situation. The headline of that article said, "Japan Imposes Sanctions Against Soviets [and] Poles." But what the story said, as it related to Caterpillar, is that Tokyo has confirmed the sale of 900 pipelayers by the Japanese. Well, we already knew that. And we told the U.S. Government that, in mid-December, before the sanctions were imposed. But the information apparently carried little weight when the sanctions decision was made.

It is true that the Komatsu commitment to the Soviets was made before the declaration of martial law in Poland. But so was Caterpillar's. The Japanese Government's response is apparently that a deal was made, and they can't renege on it. Washington's response seems to be that commercial interests must take a back seat to the symbolic expression of our dissatisfaction with the Polish situation. Is it any wonder, with these kinds of different viewpoints in Tokyo and Washington, that American firms are placed at a serious disadvantage in the international marketplace?

We keep hearing from Tokyo that the Japanese won't do anything to undermine the sanctions. And we hear from our own State Department that the continuing revelations of Komatsu sales don't violate that Japanese commitment. I'm appalled that we allow such a charade to persist. Komatsu's contracts predated the imposition of martial law. But the Japanese Government clearance was reportedly concluded in January, not too many hours before Tokyo announced it would do nothing to undermine the sanctions, adding parenthetically that their existing commitments would be honored.

In contrast, Caterpillar's experience was that three weeks after the President agreed to approve our license, the license had not yet been issued; that is despite our having provided in advance all the documents and information that had been required for a similar license case a few months earlier. It's a fine position for Komatsu—being helped by actions from both the Japanese and U.S. Governments.

As far as pipelayers are concerned, the Japanese sales appear to significantly offset any benefit to be gained by the withholding of Caterpillar equipment.

Mr. Chairman, I'd like to address for just a moment the question that is the focus of your hearings today; that is the extraterritorial application of U.S. export controls.

Leaving aside the question of legality, which others are addressing today, we at Caterpillar do not believe such application would be in the best interest of the United States. We agree with a recent statement by the U.S Chamber of Commerce that "the possibility of extraterritorial controls over the activities of West European firms utilizing U.S. technology raises serious implications for U.S foreign economic policy and our trade relationships around the world. . . . Extraterritorial controls will only aggravate further our already poor international reputation for commercial reliability."

I cannot overemphasize the importance to Caterpillar of the reputation we have sought for decades to build abroad It's a reputation for high quality equipment, and prompt, strong product support, and reliable service. But we face the recurring question of whether our government will pull that reliability rug out from under us. Make no mistake . . . that has affected our marketing activities.

Setting the precedent of applying controls to our subsidiaries and licensees abroad will further erode our international reputation and ability to compete. The same applies to other U.S firms that engage in international commerce.

It will also undermine the principle of national treatment for investments, a foundation of U.S. foreign investment policy. How can the United States continue to press countries to adopt the national treatment principle, if we insist on the extraterritorial application of our laws?

We urge the Administration not to take that additional step.

Mr. Chairman, let me repeat my thanks for the invitation to appear here today. I know this is a delicate and controversial subject, and it is important that all perspectives be heard. It is especially important, I think, that U.S. commercial interests not be simply set aside when other problems press in on our country. I appreciate having had the opportunity to present that point of view.

I look forward to responding to your questions.

Senator MATHIAS. Thank you very much, Mr. Chapman.

If it is agreeable to the chairman of the committee, I will ask Mr. Downey to present his statement, and then we will ask questions of both witnesses together. I would point out to our distinguished chairman that, while Mr. Chapman is his constituent, Mr. Downey is my constituent.

The CHAIRMAN. Well, I will yield equal time. After all, you are the chairman today.

Senator MATHIAS. While we cannot claim that he has been 30 years with the chamber of commerce, his influence and his weight is such that he might just as well have been 30 years with the chamber of commerce.

Mr. Downey, we are very glad you are here.

## STATEMENT OF ARTHUR T. DOWNEY, ON BEHALF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. DOWNEY. Thank you, Mr. Chairman.

I am speaking today on behalf of the chamber, but I am not employed by the chamber. I am a practicing lawyer in Washington. I do chair a task force of the chamber on trade with nonmarket economies, and it was in that capacity that the chamber asked me to speak to you today.

I should note that the views I express are those that I am expressing for the chamber and do not necessarily represent the views of my law firm or its clients, or any other organizations.

I do have experience in this area. I served as Deputy Assistant Secretary of Commerce. Indeed, at that time I had the benefit of Mr. Chapman's views. He served on my advisory committee while I was there. I also previously served in the National Security Council staff about 10 years ago.

I am not going to address the legal aspects of the issues you addressed, though I am an adjunct professor of law at Georgetown Law School, where I teach a course in international economic coercion, since our colleagues on the second panel will be addressing those subjects.

The administration has made it clear that it views the Yamal pipeline as not in the best interests of the free world. Obviously, the Europeans have decided that it is in the best interest of their part of the free world. The stated administration view seems to be based on two factors: First, the increased dependence by Europe on Soviet gas, with its inherent exposure to unacceptable levels of leverage; and second, the likelihood that the Soviets would use large hard currency earnings to purchase high technology in the West to upgrade its military potential.

We find these factors somewhat confusing. On the second point, one would assume that the answer is for responsible governments to prevent the sale to the Soviet Union of militarily significant technology. On the first point, the Europeans, clearly unhappy with any increased dependence on any external source of energy, are prepared to accept this risk of increased dependency in exchange for receiving greater diversity of supply and enhanced exports.

The administration views the pipeline issue as a matter of the highest national security. However, the controls that it has imposed so far have been taken not under the national security provisions of the Export Administration Act, but rather under the foreign policy authority of that act.

The American business community, as reflected by the chamber, clearly and fully supports the imposition of controls for national security purposes when justified. But we have very serious concerns over the imposition of foreign policy controls when exercised unilaterally. The President clearly has the authority to prevent exports from the United States of products and technology for use in the Soviet pipeline, and the President has exercised that authority.

Why did he do it? What was the purpose and what was the cost? It is clear that the cutoff of exports from the United States for the pipeline will not stop and will not substantially delay the pipeline. The Soviets had already learned that we are unreliable. They had sourced most of their products in Europe. Where U.S. suppliers were needed, alternative suppliers are available.

Without any significant effect on the pipeline, the existing sanctions or controls are there as a symbolic act. Perhaps that is a sufficient reason for the imposition of the controls. But, nowhere has there been clarity on the cost of offering that symbol, the cost in jobs, profits, and in the creation of new and more weighty permanent foreign competitors.

If we are to use economic sanctions against the Soviet Union because of Poland, one must question, why has the administration chosen to inflict the damage only on the export sector of this economy, and only on part of that. The main reason is the President has been given by Congress the authority to act alone in that sector, absent an emergency.

Untouched are the import sector, the financial sector, and the services sector. Perhaps the law should be changed to remove this narrow, but very attractive, tool from the President's exclusive use. Perhaps congressional action should be required for the President in the future to impose economic sanctions in a nonemergency situation, and perhaps economic sanctions should deal with matters larger than the export trade, our most vulnerable sector.

As I indicated, the administration already has acted to prevent the export from the United States of products and technology used abroad in the pipeline. I have expressed doubt as to the wisdom of that unilateral action. However, there are rumors that the administration will go further, to attempt to prohibit the sale from abroad by foreign companies unaffiliated with American companies of direct products and data previously exported from the United States without control.

Such an action would represent an extraordinary step. I do not believe the administration will take that step. I clearly hope it will not. Without addressing whether or not the administration has the legal authority to do so, whether it is sufficiently clear, such a step would be manifestly unwise.

The administration failed, as the chairman said, to persuade the Europeans of the U.S. view of Europe's best interests. Maybe the project was already too far along for this administration to act to stop it. Perhaps the administration had considered threats to Europe, threats of reassessing our NATO commitment, threats to retaliate against European companies in the United States. Maybe we considered incentives for the Europeans. Maybe we considered offering to ease pressures on the European steel exports to the United States, or the European agricultural policies. Maybe we considered taking painful steps of our own which could hurt the Soviets and which could also demonstrate to the Europeans the seriousness of our approach—the grain embargo.

Without regard to how we arrived at this point, the bottom line is that we did not persuade them of our position. We should be trying to assist the Europeans in the development of effective contingency plans to allow for substitutions and alternative energy supplies so as to diminish the opportunities for the Soviet Union to make use of any sort of gas weapon to exert political pressure.

Instead of doing that, if the United States acts, as rumored, in such an extraordinary way, we would be acting out of petulance alone. We would achieve nothing but the self-gratification of a childish temper tantrum, and we would lose a great deal. We would have exacerbated the centrifugal pressures already in the strained alliance, and the sole beneficiary would be the Soviet Union.

The U.S. business community, already shaken by earlier tests of its reliability, would be seriously damaged. Such action would not be the action of a confident great power. By resorting to the legal and economic equivalent of brute force, the United States would continue to loosen its claim to leadership in the free world.

Thank you, Mr. Chairman.

[Mr. Downey's prepared statement follows:]

### Prepared Statement of Arthur T. Downey, on Behalf of the Chamber of Commerce of the United States

Mr. Chairman, I am Arthur T. Downey, partner in the Washington office of the law firm of Sutherland, Asbill and Brennan. Prior to this position, I was responsible for the administration of the United States' export control process as Deputy Assistant Secretary of Commerce for East-West Trade. In addition to my private legal practice, I am also chairman of the U.S. Chamber of Commerce's Task Force on Trade with the Nonmarket Economies, the unit responsible for formulating the Chamber's positions on East-West trade policy.

Among the issues of current concern to the Chamber's task force, few have wider ranging policy implications than the question of U.S. extraterritorial controls over U.S. technology to be used on the construction of the Soviet Yamal pipeline. I would like to use the occasion of this hearing to comment briefly on some of the Chamber's thinking on these larger policy implications.

Chief among the concerns commonly cited by the Administration for its opposition to the pipeline is the potential for Western European energy dependence on the Soviet Union. It is is our belief that, should the Administration be concerned about West European energy dependence on the Soviet Union, the Middle East or anywhere else, then the United States should be working with the Europeans to develop timely alternative energy sources. The Soviet pipeline is not scheduled for completion until the latter part of this decade. If alternative energy sources were made available to Western Europe prior to the pipeline's completion, the problem of energy dependence would be greatly ameliorated. Indeed, it might then be argued that the pipeline would give the Western Europeans, as hard currency importers, a degree of leverage over the Soviets rather than vice versa.

If the Western Europeans are firm in their decision to go forward with the pipeline, as many in the Administration have admitted, then it must be asked whether the divisions that will likely result within the Western Alliance as a result of our efforts to block Western participation in the pipeline are worth any advantages which might result from a delay in the pipeline's construction. Such a question must be viewed within the context of the entire U.S.-Western European relationship, a relationship currently plagued by many trade and other difficulties.

Beyond the question of energy dependence, the Administration has raised concerns over the large sums of hard currency the pipeline will provide the Soviet Union. This is an extremely important issue that raises questions that go to the core of this Administration's East-West trade policy.

While we in no way wish to belittle the Administration's concerns, it might be pointed out that this year alone the Soviets will likely have grain import needs of $6–8 billion. This figure compares with projections of $4–7 billion Soviet annual earnings from the Yamal pipeline by the end of the decade. Soviet grain import needs have traditionally been paid for in part by the export earnings derived from Soviet sales of energy resources. Rather than resulting in a transfer of hard currency to the U.S.S.R., Soviet energy sales have in the past made possible the mutually beneficial exchange of commodities between East and West.

As regards the question of most interest to this committee, the impact of an assertion of extraterritoriality on the reputation of U.S. firms as reliable suppliers

I would like to make a few brief comments. It is extremely difficult, if not impossible, to quantify international perceptions as to the reliability of U.S. suppliers. On several occasions, the Soviets have indicated to the disadvantage of the U.S. exporter that they view the United States as a supplier of last resort. Over the last ten months, the Soviets have even attempted to purchase foreign rather than American grains whenever possible.

It is not difficult to see how in the future those foreign companies that have substantial trade relations with the Soviet Union might also come to view the United States as a supplier of last resort. Should you wish to get a more precise answer in this regard, you might consider discussing the issue with Alsthom-Atlantique, AEG-Kanis, and John Brown, or any of the other companies involved in the pipeline's construction.

However, we believe that the extraterritoriality issue goes must deeper than questions related to the pipeline or to East-West trade in general. The issue goes to the heart of our international trade relations and, as such, has a crucial bearing on the national export goals established by this Administration. This is a question inextricably linked to the more general issue of trade sanctions, an issue on which the U.S. Chamber has a long-standing policy. You will find attached to my testimony a letter dated April 23 of last year in which the Chamber reiterates to the Administration some of our concerns over the use of economic sanctions. In this letter, the Chamber expresses particular concern over the proliferation of export controls for reasons of foreign policy.

Also attached to my statement is a recent Chamber letter to President Reagan outlining our concerns over extraterritorial controls as regards construction of the Yamal pipeline. I would like to read from the last paragraph of the latter document:

"(W)e would hope that the Administration has carefully weighed the consequences of any efforts to maintain strict extraterritorial control over American goods and technology abroad. In building oversea markets so vital to our economic security, U.S. export performance relies heavily on both quality and dependability. Extraterritorial controls will only aggravate further our already poor international reputation for commercial reliability."

Thank you. I would be pleased to attempt to answer any questions.

Attachments.

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Chamber of Commerce
of the United States of America,
*Washington, D.C., February 5, 1982.*

The President,
*The White House,*
*Washington, D.C.*

Dear Mr. President: We have been led to believe that the Administration is seriously considering sanctions against West European firms to force compliance with our foreign policy sanctions related to the Yamal pipeline. I want to share with you our concerns that reported U.S. actions under consideration would be unprecedented and may not be in the best interests of this country.

Western debate over the benefits and liabilities of the pipeline has set the stage for a potentially dangerous conflict within the Atlantic Alliance on the question of Soviet energy development. Rather than viewing the pipeline as a source of dependence upon the Soviets, our West European allies view the project as a means of cutting their present dependence upon Middle Eastern energy sources—a policy actively encouraged by our country until recently.

Moreover, the possibility of extraterritorial controls over the activities of West European firms utilizing U.S. technology raises serious implications for U.S. foreign economic policy and our trade relationships around the world.

If our major concern with the Yamal pipeline is the potential for European energy dependence upon the Soviet Union, then it is imperative that we give priority to helping the West Europeans develop timely alternative energy sources. This need not suggest that we should undertake a simultaneous effort to impede construction of the Yamal pipeline. A good case can be made that the pipeline increases total world energy supplies to the overall benefit of the United States. Furthermore, if alternative energy sources were made available to Western Europe, it could be argued that the pipeline gives these countries, as major importers, a degree of leverage over the Soviets rather than vice versa.

On the other hand, if the Administration's objective is to minimize the contribution the pipeline might make to the Soviet economy through hard currency earnings, then this raises a new and unprecedented issue which goes to the core of U.S. policy on East-West trade. Such a profound change in policy could be likened to a strategy of economic warfare. Undoubtedly, it would require a recalculation of international business strategies for many U.S. firms involved in trade with Eastern and Western Europe If this is the approach being considered, I urge the Administration to consult with the business community before such a policy is announced.

Finally, we would hope that the Administration has carefully weighed the consequences of any efforts to maintain strict extraterritorial control over American goods and technology abroad. In building oversea markets so vital to our economic security, U.S. export performance relies heavily on both quality and dependability. Extraterritorial controls will only aggravate further our already poor international reputation for commercial reliability.

Sincerely,

RICHARD L. LESHER,
*President.*

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CHAMBER OF COMMERCE
OF THE UNITED STATES OF AMERICA,
*Washington, D.C., April 23, 1981.*

Hon WILLIAM E. BROCK,
*U.S. Trade Representative, Winder Building, 600 17th Street, NW., Washington, D.C.*

DEAR BILL: I am writing to you in your capacity as chairman of the Trade Policy Committee. It is our hope that the Committee will work closely with the U.S. business community for the establishment of a coherent U.S. trade policy. In particular, we hope that business views will be factored into the formation of an export administration policy.

The Export Administration Act of 1979 recognizes that uncertainties in export control policy may curtail the efforts of American business to the detriment of the U.S. balance of trade. The U.S. Chamber was an early and vocal supporter of the Act in the belief that the legislation created an equitable balance between legitimate security and policy concerns and the need to increase American exports. However, the proliferation of new export controls on the grounds of foreign policy and national security has contributed to further uncertainty and frustration on the part of U.S. exporters.

American policymakers have viewed export sanctions erroneously as an effective and relatively inexpensive means by which to achieve the country's political objectives. This view is an outgrowth of the days when the United States was the preeminent economic power of the world and in many instances the sole international supplier of equipment and technology. Although this no longer is the case, policymakers in this country have exhibited an increasing tendency to use trade as a means to further such goals as the suppression of international terrorism, the enhancement of human rights, or the cessation of military aggression.

Trade sanctions have not had a clear record of success whether imposed multilaterally (Southern Rhodesia) or unilaterally (South Africa). The most dramatic use in recent years of U.S. trade sanctions were those imposed in response to the Soviet invasion of Afghanistan. In light of the current review of U.S.-Soviet relations, we believe this is an appropriate time for the new Administration to examine these and other sanctions to determine whether they have had their intended effect and to measure this effect against the costs of such sanctions to the United States. In this regard, the experiences of some of our member companies may be of interest.

As you know, several U.S. firms trace their commercial ties with the Soviet Union back to the 1920s. However, with the direct support and encouragement from the U.S. Government in the 1970s, many other businesses began to develop Soviet trade ties for the first time. We know that a number of these companies are reevaluating their commercial relationships with the U.S.S.R. It is clear now that, unless a degree of predictability is returned to the U.S. commercial decision-making process and a considerable measure of trade is restored, many companies will cease doing business in the Soviet market altogether.

Perhaps the best single example during the past year of the apparent ineffectiveness of trade sanctions involves Soviet efforts to construct a steel mill for the production of electrical steel at Novolipetsk. American companies had negotiated for as long as five years to participate in this project, and of the $353 million to be invested in the project, it was expected that $100 million in orders for U.S. equipment would result. With the imposition of U.S. sanctions, the U.S. contracts were terminated and awarded shortly thereafter to the French.

Another major project involved negotiations for the construction of an aluminum smelting complex at Sayansk. In this instance, an American company was forced to pull out of the final stage of negotiations, which would have likely resulted in the purchase of another $100 million in American equipment and technology. In this case, the West Germans were the recipients of the business lost by the United States.

Another major deal which might have resulted in American sales of some $100 million involved Soviet purchases of equipment for a project in that country's energy infrastructure. In this case, American suppliers traditionally serving Soviet needs in this area were not even invited to bid on the equipment. Instead, the Soviet Union turned to the Japanese for the necessary equipment.

Loss of participation in these three projects alone has meant a loss of some 5–6,000 potential jobs in this country, based on U.S. Department of Commerce multipliers. If this loss were measured against benefits to our national security, such as an inability of the Soviets to proceed with these projects, U.S. business would be less critical of the actions of our government. As it is, the projects are going ahead and the potential U.S. jobs have been merely given up to our trade competitors.

With the embargo on phosphate sales to the Soviet Union, again U.S. sanctions have had little effect other than to harm U.S. commercial interests. Since the embargo, the Soviets have obtained alternate supplier of phosphates from Tunisia, Morocco, Belgium and South Africa. Even more disturbing and far reaching is the fact that the Soviets have begun discussions with France and Morocco concerning the possible construction of superphosphoric acid plants to satisfy long-term Soviet needs. U.S. sanctions, rather than harming the Soviets, have put the United States in the position where it stands to lose tens of millions of dollars worth of sales to the Soviet Union and have encouraged the creation of a permanent competition for U.S. suppliers.

Because of U.S. price supports and government purchase programs, it is much more difficult to assess the direct economic impact on U.S. agriculture of the U.S. embargo to the Soviets of grain and other agricultural commodities. Perhaps a more important question is the long-term effects on future trading patterns resulting from a Soviet perception of commercial unreliability of U.S. agricultural suppliers. The economic impact on the Soviet Union of the grain embargo is also open to question. According to original Department of Agriculture projections, the cancellation of 17 million metric tons of U.S. grain shipments would result in a total Soviet shortfall of 8–13 million metric tons. Some recent estimates, however, place Soviet grain imports last year as high as 36 million metric tons, which, if true, would seriously call into question the effectiveness of the U.S. embargo.

There are numerous other examples where opportunities for U.S. sales were sacrificed to the advantage of our trade competitors without any perceivable impact on the Soviet economy. This is particularly true in the electronics and energy fields. In addition, such losses have a multiplier effect on related fields, such as transportation and insurance.

In light of these results, the U.S. Chamber offers the following recommendations for consideration by the Trade Policy Committee:

First, the President's ability to employ export controls to further our national security should be continued. Such controls, if undertaken within the letter and spirit of U.S. law, should be supported. Implicitly, however, this requires real determination of the actual contribution of U.S. exports to the military potential of an adversary country. Furthermore, the imposition of such controls, except under the most extreme circumstances, should be mutlilateral in nature, with the full support of our allies.

Second, there is ample evidence that the unilateral imposition of trade sanctions has been ineffective in changing foreign behavior. Recent sanctions invoked for foreign policy purposes have been imposed without due regard to the provisions of the Export Administration Act requiring the President to determine the likelihood that export controls will attain foreign policy objectives and determine the probable domestic economic consequences of such sanctions. The existence of alternate suppliers of goods, technologies and services has undermined the effectiveness of unilaterally imposed export controls, and as a result, these controls have had merely a symbolic rather than substantive effect. Consequently, we believe that unilateral trade sanctions for foreign policy purposes should be avoided as they have proven to be costly in terms of lost exports, foregone, markets, and allegations of commercial unreliability.

If the President determines that the employment of economic tools to achieve foreign policy goals is essential, consideration should be given to broadening the sanctions to include all facets of economic interaction, including investments, imports, and services such as transportation, insurance and banking. There is no reason why the U.S. export sector alone should be forced to shoulder the burden of U.S. policy decisions. Furthermore, we believe that the President, when faced with the possibility of restraining all facets of trade and economic cooperation, may give closer consideration to the economic consequences of foreign policy sanctions and, therefore, invoke such controls in only the most serious situations.

We hope these recommendations will be of value in the course of your reevaluation of U.S. trade policy. We believe there is an urgent need to return a degree of consistency and predictability to the U.S. export administration process and view this as a key step in any program to improve the competitiveness of U.S. exports abroad.

Sincerely,

RICHARD L. LESHER,
*President.*

Senator MATHIAS. Thank you very much, Mr. Downey.

I want to yield to the chairman of the full committee for his questions. But before I do, let me ask a question which I think sets the stage for our discussion, because we have billed this as a hearing on extraterritoriality.

I want to submit to you a further issue which may be as important or perhaps even more important than the question of extraterritoriality and which is implicit in this subject. That is the question of retroactivity, which has not really been talked about very much in this context. If you read the notice that was published in the Federal Register on January 5 of this year, as well as the actions that are reported even as late as this morning to be still under consideration within the administration, there is indeed an element of retroactivity which is extremely important.

To make myself clear, let us say that a manufacturer exports widgets today or even exported widgets 10 years ago under a general license. The foreign purchaser has no assurance that the U.S. Government may not decide 10 years from now or may not decide today, retroactively, that the widgets exported 10 years ago should not be reexported, say to Abu Dhabi or any other spot on the globe you may wish to choose, and therefore inform the foreign company that it will lose all U.S. trade privileges if it exports widgets to Abu Dhabi.

So the question arises, are there any limits to the reach that has thus been asserted? Is there any firm anywhere that has purchased U.S. equipment or technology which can be absolutely sure that it will not be subject to U.S. export controls at any time?

So I think perhaps one of the larger questions before us today is how the United States can restrain itself for the sake of international comity while continuing to maintain an effective export control policy. That is an extremely complex and difficult question. I am sure that that was one of the things Mr. Lesher had in mind when he wrote to the President on February 5 and called this unprecedented, because it seems to me it is an extraordinary exercise of regulation and control on the part of Government.

Perhaps you would like to say a word on the retroactivity question.

Mr. DOWNEY. Part of the problem, Mr. Chairman, is that the concepts in the Export Administration Act that underlie the broadest possible reach of jurisdiction historically have been based on national security. We all are more inclined to accept a greater reach abroad to protect our national security. The problem now arises, however, where the same theoretical jurisdictional authority is being called on for a foreign policy control where our national interests are not as directly put on the table.

In addition to the Soviet problem which you are addressing this morning, you may be holding a hearing in a few days on the same situation arising out of Libya. All the statements in the press mention the anticipated imposition of foreign policy controls on exports of American oil field equipment to Libya. You can have the same situation arise where an American company might have provided technology years ago, or products, to Britain or to France, to their subsidiaries or unrelated companies in those countries, and those countries want to continue to sell to Libya, wrongly perhaps in our view, but they want to do it.

So the issues that you are addressing are the twin issues of retroactivity and extraterritoriality. When combined, I think they really produce a most interesting result. By raising these twin issues, you have hit across the board in many different contexts; you may have the same issue with regard to Libya tomorrow, as you do with the U.S.S.R. today.

Senator **Mathias**. So then, once you touch the subject, you then are always liable to some unexpected control.

Mr. **Downey**. To be more precise in answering your question, your specific question I think would be viewed by the people who administer this law as not being a question of extraterritoriality. As you posed it, the question was: An export of a product from the United States 10 years ago lands in country X and that country wants to reexport it. I believe they would view that as a situation where the United States would be exerting a control over an American product. The fact that it has changed hands is irrelevant in their minds. Again, the underpinning for this is our national security. If there is a product which has a direct bearing on our national security and gets into the hands of "crazies," the U.S. Government would want to be able to reach out and to grab it.

A much more difficult problem is the one where we transfer technology abroad. We can still assert a control over the reexport of the technology, but the problem arises when we try to assert a control over the products of the technology. That is the most difficult issue. In my view, it is something that we should not allow.

The only way we may be sure that it will not happen is to remove from the President the authority to impose all foreign policy controls, absent an emergency. Otherwise, we will have the situation that we had some years ago in the mid sixties with the *Fruehauf* case, a very famous case, as you are well aware, involving China and France. There has not been an extreme reach since then, but that is what we are talking about.

Senator **Mathias**. Senator Percy.

The **Chairman**. Thank you, Mr. Chairman.

Mr. Downey, in your testimony you touched upon the same subject that Mr. Chapman touched on with such feeling, that of the reliability of an American supplier. When we see instances, as you pointed out, that the Soviet Union now is buying American grain as a last resort, rather than up front, putting us at the end, who is really hurt if they are able to get that grain?

Now there will be no grain embargo under present conditions. Our grain is available. The Government is paying billions of dollars to farmers for surplus grain that is simply being stored. We are paying interest on that storage. I have seen it all over the Midwest this weekend. A lot of it is owned by the Government. We have paid for it and it is sitting there, costing us all money.

Who then is hurt if we are not shipping it under these conditions to the Soviet Union? Is it a privilege to buy from the United States or is it a benefit that is two-way? And in this case, when we have so much surplus grain, do we not end up better off getting hard currency which we can use to relieve our debt, to relieve the farmers?

Are we not really hurting ourselves unnecessarily when grain can be purchased around the world?

Mr. DOWNEY. I am in the embarrassing position of agreeing with everything that you and Senator Mathias have said on this entire issue so far. I am delighted to see these sort of sentiments arising from your side of the table.

One can go back even before the grain problem with the Soviets to another problem, of which you are well aware, that of soybean exports to the Japanese of about 10 years ago. We had a virtual world monopoly in the sobyean market. By unilaterally acting to cut off those exports to the Japanese, the Japanese did the only wise thing: Pour a lot of money into Brazil to create additional soybean competitors. Now we have lost the monopoly.

We seem to be doing the same thing in the oil field equipment business. We had, and we still have in some narrow areas, a monopoly on these products. As soon as those exports are cut, as soon as our unreliability is absolutely demonstrated, it will take a little money and a little further incentive for the Japanese or for 20 other countries to get into that business. As a result, we will lose our effectiveness, we will lose our competitive stance. We will create competitors.

And the bottom line for the Soviet Union is zero impact.

The CHAIRMAN. It seems apparent to me in that case who is the winner and who is the loser. The Soviet Union is not a loser if it can buy it elsewhere. In this case the Japanese were not the loser, because they had a dual source of supply, which weakens prices and gives them a better break. The Brazilians have a new market, a new outlet. The U.S. farmer and the United States economy are the only ones who really lose.

When we look at the estimated income—Soviet earnings in your statement are estimated to be between $4 and $7 billion annually from the Yamal pipeline by the end of the decade. Offsetting that against a grain import need of $6 to $8 billion and going up probably, there is an opportunity that we have to earn that and get the hard currency right back for grain that is consumable and usable.

Also, is it not true that there is an estimated $12 to $15 billion cost of the pipeline? You have to add to that interest. Here I hope there is no concessionality. This is not a developing nation. The European countries do not have to reach overboard with credit terms. They can and should drive a hard bargain in this instance. This is something they want to do.

Is not that income of $4 to $7 billion by the end of the decade needed in the meantime to pay off the capital costs of that pipeline?

A large part of it will go toward that. It will not accumulate real surpluses. I do not anticipate they will have big surpluses for a long time to come with the way their economy is going.

Mr. DOWNEY. This, Senator, is the big bugaboo that the administration has been raising, as I indicated earlier, about the vast sums of hard currency the Soviets will earn. In the view of the administration, they will most likely use that to buy high technology from the West, to beef up their military.

That simply is no answer. We have to protect our militarily significant technology. We should not sell it to them. But that is our responsibility as a responsible government.

Will they earn hard currency on this? Yes. But they also will have to pay for the pipeline and everything else. They will also have to pay for the grain and other things that they need.

I do agree with your concern about subsidized interest payments. There we have failed completely; that is, the West has failed completely. It is an area where the United States really should be asserting much more leadership. The Soviets are getting concessional credits, and that is outrageous.

Normally, when one country uses the Eximbank equivalent for sales financing to another country in the Western World, it is an ultimate tradeoff. The Japanese Eximbank is utilized for concessional credits for exports to the United States, and ours to them. In the long run we all benefit. But concessionary credits to the Soviet Union on the part of the Western World brings no benefits to us. It is not reciprocated, and we should stop that.

The CHAIRMAN. I have advised the Department that I would support that position, though they know how I have opposed other sanctions that I consider not to be effective at all. I think in the area of credit concessionality much can be done.

Mr. DOWNEY. But it must be done, as in all of these areas, multilaterally.

The CHAIRMAN. I want to read a sentence which appeared in an editorial of the Peoria Star-Journal. Let me see if I can locate that. I am afraid I cannot find it.

Mr. Chapman, I have a couple of questions for you. In your testimony you spoke of Caterpillar's reputation as a reliable supplier. Would you give us some specific examples, either now or for the record, where the reputation of the company has been impaired because of U.S. economic sanctions?

Mr. CHAPMAN. Thank you, Senator. I think the story related earlier in my testimony is a good example of the dilution of our reputation as a reliable supplier. In 1978, when the first controls on oil production equipment were initiated, that was the beginning of the downfall of Caterpillar's reputation as a reliable supplier.

We had on the docks in New Orleans a shipment of parts for pipelayers to the Soviet Union when that regulation was announced. As a matter of fact, some of the shipment was loaded on the vessel—a Soviet vessel, by the way. We called the administration to find out if this new regulation applied to parts for pipelayers. We were told that it did and that if we did not want to be prosecuted under the terms of that regulation we had better get those parts off that ship.

Well, I will tell you, that was quite a job to do, to take parts off a Soviet ship which already had been loaded. The Soviets obviously were furious, because these parts were needed and there had never been any indication in their mind that there would be any problem in getting parts for the several hundreds of machines they had previously purchased.

We finally did get approval to load the parts after the vessel had gone up to Houston and had come back down to New Orleans. But at the same time, we had an order for, I think, about 100 pipelayers, which was immediately brought into question. The Soviets again were very upset that now they had to provide end user statements which attested to what the machines were going to be used for, that they would not be used for any other purpose, that the signer of the form was truly representative, capable and justified in signing that form.

It was all bureaucratic redtape. Again, that order was finally approved on the basis that it was recognized that pipelayers were not high technology equipment. But Senator, that was the start of our losing the business in the Soviet Union. The Soviets immediately turned to other suppliers and encouraged them into the business.

Up to that time the performance of our product, the outstanding parts service that we gave them, which was completely new to any aspect of the Soviet Union, and the delivery performance that we had created had given us a clear competitive advantage. But the imposition of sanctions, the uncertainty of whether or not they could indeed order equipment and have it received in the time in which they needed it, whether indeed they would be able to obtain parts over the long pull for the machines purchased, began to undercut our reputation.

We made some recovery and we did sell a few machines since 1978. But as I already have testified, the great majority of that business was given to the Japanese.

We have felt recently, despite the background of dissatisfaction and frustration on the part of the Soviets, that we might have an opportunity to compete effectively for a significant segment of some 48,000 kilometers of pipelines that the Soviets plan to build in the next 5 years. This of course now is completely out.

Quite frankly, Senator, I do not really know what our short-term position will be in soliciting business from the Soviet Union.

The CHAIRMAN. Looking at unemployment, say in Illinois, as Senator Mathias has previously done—and I would like to say first that Senator Mathias' taking the chairmanship of this subcommittee puts him in the forefront of fighting for Maryland, indeed for this whole region here, because there is so much work that we on this committee do in this regard. We in Illinois work very closely with industry to protect our markets. I do not know what Maryland is, but we are fourth highest in the Nation.

Senator MATHIAS. It is too high.

The CHAIRMAN. It is too high. It is undercutting our budget. It is adding to the deficit and adding to unemployment compensation and welfare costs. We are running unemployment rates at 18 to 22 percent in some cities in Illinois. It is just staggering.

Would you comment on some companies in related industries, such as our largest manufacturer in Springfield, Fiat Allis. International Harvester was on the verge of bankruptcy last December, owing $9 billion, and having that company struggling for its existence.

You know personally that these economic sanctions have more adversely hurt those companies, created more unemployment in Illinois. And yet, as you look at the product lines that are being sanctioned, the Soviets are not really being hurt by being deprived of it.

Before you answer, I did find that Peoria Star-Journal editorial of February 26. The two paragraphs say that:

> If the Soviets can buy Komatsu pipelayers from Japan, which they are doing, our embargo becomes a meaningless, self-defeating gesture. It is as if we refused to let the Russians buy Chevrolet Cavaliers and they just shrugged and bought Honda Accords. That is some embargo.

That is about the position that we really are in. It puts it in as straightforward and simple language as we can put it.

Perhaps you could comment on other companies whose past history and present positions you know well.

Mr. CHAPMAN. I would not wish to presume to speak on behalf of the other competitive manufacturers in the State of Illinois who are in the same business as we, Senator. But nonetheless, I am aware of their situation to some degree by what has been printed in the media.

Certainly, the situation with Fiat Allis is a very desperate one, in which they are really fighting to stay in business. According to their reports, they will be seriously affected by the sanctions that are currently in order.

I do know that the State of Illinois needs jobs. The State is a heavy basic industry-oriented State. It just so happens that the largest single market in the world for the kind of equipment we are talking about today is the Soviet Union, and it will continue to so be for at least 5 years into the future if the Soviets indeed continue to pursue their plan for the next 5 years.

I might add that the Soviet Union is by far and many times over the largest owner of Caterpillar 594 pipelayers in the world.

The CHAIRMAN. Yes; and that has reversed totally in the recent period.

Mr. CHAPMAN. From the 85–15 to the 15–85.

Unfortunately, Senator, and I would like to make this point again, it is really with no benefit either to the United States, the State of Illinois, or to our own company or other companies in the State.

The CHAIRMAN. I have one last question for both of you. I have taken the position that if our technology is absolutely unique and is high technology, it may have a dual usage in that it may be useable in their defense industry, so we would have no obligation to strengthen them in the defense end when they are in an adversarial position, a threatening position to us around the world. I really know of no American company that takes the position that that is not a different case.

What we are talking about is not high technology. It is not unique. It can be supplied readily by others. For that reason, we are the ones who are being adversely hurt, not them. In fact, it helps them divide the allied world in a sense, pitting one member against the other.

Is my assumption correct that American industry and I think American farmers in the end, if it really made a difference, would support it, but they would only support it if it was universal and across the board? And I think it might have been with all allied countries if say the Soviet Union had moved into Poland something of a different case.

Mr. **Chapman**: I do not think I could have stated that any better, Senator.

Mr. **Downey**. Senator, I agree completely. I think your overall point on the costs—the costs in Illinios, the costs in jobs—is an important one. It is for that reason that we suggest that with respect to foreign policy controls, though not national security controls, that you remove the authority from the President and the executive branch, absent an emergency, and put that authority back into the Congress.

If you are looking for a step short of that you might consider the following: In the current act, the President is required to consider a series of factors, including the impact on the domestic economy, on jobs, et cetera. But he does not have to publish what he has considered or make any statements on it, except on an annual basis. You could, as a small step, require the President to lay out his justification in public, lay out the impact in Illinois, on Caterpillar, et cetera, so that there is a totaling up of the costs before he imposes a foreign policy control.

The public can then judge whether this a truly symbolic act which has no effect on the Soviet Union, or whether it is worth the cost. You do not know that now. Nobody knows it until year end when there is an annual review. But it might be good to have that up front.

The **Chairman**. Thank you very much.

Mr. Chairman, I want to commend you on these hearings. They help us focus on this issue and sharpen up our thinking on it.

I would be very surprised if a decision was not made along the lines of your testimony. I think the potential repercussions from an extraterritorial application would just be horrendous. I think we all know that, and you have sharpened up the issue very much indeed for us. We very much appreciate your testimony.

Thank you, Mr. Chairman.

Senator **Mathias**. Thank you, Mr. Chairman.

Mr. Chapman, one source of frustration about the European pipeline is the sense that in some way the construction of the European line will compete for equipment or financing with the line to bring Alaskan gas to the Midwest. In your judgment, does the construction of the Soviet pipeline make the Alaskan-Canadian pipeline any more difficult or any more costly?

Mr. **Chapman**. Mr. Chairman, that is a very interesting theory, which quite frankly I had not heard before. I think it would be very difficult to prove that the Yamal pipeline construction would have any effect on the building of the pipeline from Alaska to the Midwest.

Certainly the pipe is available from other countries. They are operating at less capacity for that size pipe. Certainly, the pipelaying equipment, as has been said, certainly is available. As far as credits are concerned, I understand the Yamal pipeline is basically government-financed by those countries primarily participating in the use or purchase of the gas.

The Alaskan-Midwest pipeline will be a privately financed program. My judgment would be that someone would have to really expand their imagination to see any connection that might exist that would have any effect on that.

Would you not agree, Art?

Mr. **Downey**. I would agree absolutely; the most remote impact.

And the only thing that I could think of would be if a company like Caterpillar had been able to retain its contracts in the Soviet Union, it would have longer production runs for the equipment it would use in the Alaska line. And it may be now, for example, with the Japanese activity on the Soviet pipeline, you might find the Alaska pipeline being made with Komatsu pipelayers, because they may be cheaper and better because of the long production runs that they would have. That is a remote point and an unpleasant one.

Senator **Mathias**. Mr. Downey, the question of extraterritoriality is a difficult one and a very complex one. I would not want to leave you or anyone here with the impression that it was a principle that never should be employed. I do not think we can contemplate a world in which corporations skip over national boundaries the way bootleggers used to skip over county lines just one step ahead of the sheriff, to avoid any kind of national controls.

In an orderly, stable and equitable world, there may have to be some way in which nations reach beyond their boundaries to control the creatures, the corporate creations for which they have been responsible.

When you look at some of the recent examples, such as the Cuban buses, the seizure of Iranian assets, the attempt to impose sanctions on Libya, do you see this really as a very profitable way to exercise extraterritoriality?

Mr. **Downey**. No, Senator, I do not. I think the Cuban bus example is a good one, in the sense that that was an egregious reach by us. And since then—1975—our regulations have changed. So that example as a practical matter should not happen today.

As you say, there are illustrations in our laws where some elements of extraterritorial reach are acceptable. As you well know, parts of our laws and regulations with respect to the Arab boycott of Israel contain elements of extraterritoriality. The difference is that those elements were reached after exhaustive hearings, and legislation which precisely laid out guidelines, so that you know in advance. It is not something that comes at you from behind in the night, as the subject of this hearing.

I believe it is important, as I have said, to remove the authority for unilateral foreign policy controls from the President, so that in the future if there is a need for action absent an emergency, it can be debated here in the Congress the way the boycott legislation was debated.

Historically, economic sanctions have been ineffective even when applied mutilaterally. The economic controls and sanctions over Rhodesia never really worked. Our own controls over South Africa in the nonmilitary area have had no impact except to lose American jobs.

There are times when a symbolic action is important, when the foreign behavior is so egregious that we should stand up, but at least that we should know the costs.

Senator **Mathias**. In your response to Senator Percy on the grain question, you suggested an argument that had been made to me by someone on behalf of the administration, that in selling the Soviet Union grain we actually were imposing a damage, because we were depriving them of hard currency. What do you think of that argument?

[General laughter.]

Mr. **Downey**. I think that is an absurd argument, not worth discussing.

Senator **Mathias**. There is the question, however of subsidized credits to the Soviet bloc. How do either of you feel we best can gain European and Japanese support for ending subsidized credits to the Soviet bloc?

I assume that declaring the Polish debt in default and invoking all the cross-default provisions, whatever they may be, is not the way to go on that. What would be a practical way to proceed?

Mr. **Chapman**. I am not sure that I know the complete answer to that, Mr. Chairman. But it would seem to me that it would have to take place at the same level that we talked with our associate countries in Western Europe on those items that can or cannot be exported to the Soviet Union.

In the case of the pipeline, it would seem to me that it really is a hypothetical question, first of all. As we all know, the United States does not give concessionary financing to the Soviet Union. Other Western countries do. But in the case of the pipeline, in which the pipeline and its total cost is to be paid by the Soviet Union through gas supplied, it would seem to me that the credit concessions will be taken care of in the added value of the total amount of gas purchases made. I do not know whether or not that is true.

My point is, I think if we went to the Western European countries today and urged them to modify their concessionary financing on the Yamal pipeline, they could just take it out of one pocket and put it into another. I do not think it would really make that much difference to them.

Senator **Mathias**. What about the question of gaining allied support and cooperation for the whole matter of sanctions? Chancellor Schmidt has said frequently, as you said this morning, that we impose the sanctions before we consult our allies, before we enter into some negotiations. I assume from what the Chancellor says that he thinks there would be a greater chance of international acceptance of the sanctions if we did consult before we acted.

But what about the business community? Do you think the private sector would extend a greater degree of cooperation if there were this kind of public negotiation and discussion prior to the imposition?

Mr. **Chapman**. Oh, yes, Mr. Chairman. I am confident that this would be so, because at least private business would have the opportunity to present its views on what the possible effectiveness might be of the legislation being considered. I think that is the way the system should work.

As Mr. Downey has pointed out, in this instance the opportunity to put on the record our opinions was not given to the business community. I think it is a very important step in the generation of agreed-upon Federal actions.

Mr. **Downey**. Mr. Chairman, you raise a number of very interesting questions. With respect to the first one, on the subsidized credits for the bloc, I would like to suggest first that I do not believe we should be thinking still in terms of a monolithic bloc. There is an enormous difference between the Soviet Union on the one hand, and Hungary on the other hand. It would be important for us to look at the impact and the role with respect to each of the countries.

I would hate to see all the Eastern European countries swept into the attack on the Soviet Union.

With respect to the subsidized credits, how do we get our allies to do it, I think that is tied to the second point relating to the need for advanced consultations within the alliance. Until very recently, we have failed miserably, in my judgment, to give sustained, consistent and high-level attention to the overall problem of our trading relationships with the Eastern countries, and the Soviet Union in particular.

We have treated it in pieces. We treat the export of high technology and militarily important products in one body at a relatively low level in COCOM in Paris. We treat the financing issue in a different body, and we treat the other arrangements in other bodies.

What is needed, what has just begun to happen in my judgment, is a periodic, regular consultation among the leading Western countries, basically the economic summit seven, to address the range of issues at a very high level, at the under secretary level including expressly the military. If the military in any of our allied countries were permitted to comment on the impact of financing, for example, subsidized credits, that could encourage those countries to join with us.

If we could do something like this and deal with it in that highly secret fashion at one point, then later in a public fashion in the United States, the American business community would stand up and applaud and say, we are doing something in a united way which is effective, we are prepared to sacrifice our jobs because we are not creating other jobs in Japan, and we are achieving some enhancement of our foreign policy position. You would have support which then would provide a more effective lever.

Today, however, we are leading with our weakest weapon.

Senator MATHIAS. I have one final question, and it is a detail that came up in Mr. Chapman's testimony. You said that 3 weeks after the President agreed to approve your license the license had not been issued?

Mr. CHAPMAN. That is right, Mr. Chairman.

Senator MATHIAS. Whose responsibility was the act of issuing the license?

Mr. CHAPMAN. We have asked that question many times, but we really have not received a good answer.

Senator MATHIAS. And it is your judgment, as you testified, that because of that delay it gave your competitors an advantage from which they were able to benefit.

Mr. CHAPMAN. Mr. Chairman, what actually happened was, the delay by our not having had the license before the date of the new sanctions—our license therefore was automatically canceled. If it were received prior to December 29, it would have been honored, as all other contracts were that were received prior to December 29. That is the point.

The business that the Japanese had received at that time would not have been affected, because they had a similar order at the same time.

Senator MATHIAS. Thank you very much, gentlemen. You have been very helpful here today. We appreciate your coming.

Our second panel for the morning is composed of Mr. Stanley Marcuss, a partner in the firm of Milbank, Tweed, Hadley & McCloy, and Mr. Douglas E. Rosenthal, a partner in the firm of Sutherland, Asbill & Brennan. Gentlemen, we have written statements from each of you, for which we are grateful. The committee thanks you. Your statements will be included in full in the record. Please proceed in the order that you determine between you.

## STATEMENT OF STANLEY J. MARCUSS, ESQ., PARTNER, MILBANK, TWEED, HADLEY & McCLOY

Mr. MARCUSS. Thank you. Mr. Chairman. It is a pleasure to be here.

I think you put your finger on one of the most difficult legal issues and that is the question of ex post facto application of U.S. export controls. I will summarize my prepared testimony.

I should say at the outset that one is tempted to want to deal with the fascinating policy questions which you raise, because they are fascinating and difficult. They are long-reaching in their consequences. But I think the temptation in some respects is worth resisting, because there are equally fascinating and terribly important legal questions that need to be raised and answered regardless of one's view of the pipeline question. I propose to deal with some of those major legal issues.

It seems to me, Mr. Chairman, that there are six major legal issues and many subissues. I would like to touch on them and identify them and very briefly discuss them.

The first question is whether the current export administration regulations prohibit foreign exports of the type in question?

The second question is, assuming that they do, can they be applied today if the original export of U.S. technology that was used and will be used to produce them was pursuant to a different set of regulations?

The third question is, if the current regulations do not authorize controls over foreign exports of the type in question, can they be amended now to apply retroactively?

The fourth question is, would an effort to reach the foreign exports in question be consistent with the statute itself, that is the Export Administration Act of 1979, or the version of that statute that was in effect at the time of the original export of the technology from the United States, whenever that was?

The fifth question is whether an ex post facto effort to restrict the export of foreign-made products produced with previously exported U.S. technology would be consistent with international law? It seems to me that is an important question, despite the general disregard into which international law seems to have fallen these days.

Then the last question is whether the proposed controls would meet the criteria that are now specified in the Export Administration Act of 1979?

As to the first question, I will pass over that quickly, but will note the following. Under the current regulations, there is this provision. "No person in the United States or in a foreign country may export or reexport to the Soviet Union any foreign produced direct product of U.S. technical data, or any commodity produced by any plant or major component thereof which is a direct product of U.S.

technical data, if such direct product or commodity is covered by" certain provisions of the regulations. And there is no exception that applies.

Well, that is a fairly extraordinary assertion, as you will recognize, of the sweep of U.S. law. Be that as it may, I note that among the products that are specified as falling within that broad prohibition are products such as machinery, equipment, instruments and other commodities utilized for the exploration, production, transportation, or refinement of petroleum or natural gas, up to and including refinery operations and so forth.

I note that that was added in January of this year, 1982. So if what we are dealing with in the case of the exports in question are the direct products of U.S. technology or the products of a factory produced with a direct product of U.S. technology and fall within the category of Soviet transmission equipment and so forth, and there were no exceptions, then current regulations would apply.

Let me pass that question because there are many factual matters that determine the answer to that. Let me go to the more important questions that I raised. The next two are as follows. If the regulations apply today, can they be applied if the original export was pursuant to different regulations, regulations that did not prohibit the export of foreign-produced products? The collateral question is: If the current regulations do permit the export in question, that is to say they do not cover it, can they be amended?

Both questions involve the issue of ex post facto application of U.S. law. Analytically, it is useful to distinguish between technical data that has been exported pursuant to a general license and technical data that had been exported pursuant to a validated license. Let me explain for a moment why that is important.

Under the general scheme of U.S. export control laws, all exports from the United States take place pursuant to either a general license or a validated license. A general license is one established by the Commerce Department and no application is required for it and no document is issued. A validated license, on the other hand, is a document, permission issued by the Department authorizing a specific export in accordance with the terms of the license.

Now, if the technical data at issue here with respect to the Soviet pipeline had been exported pursuant to a general license, generally speaking there would have been no restrictions on its reexport or on the export of the products of that data. That is to say, the foreign manufacturer would have acquired the technical data without there being any restrictions on a U.S. supplier of the technology to restrict the export of the technology or the products produced by that technology.

Even if the technical data had been exported pursuant to a validated license, there may very well still have been no restrictions on reexport to the Soviet Union of the product of that data. The latter of course is a factual question.

Now, one section of the regulations provides that all export licenses and other authorizations to export or reexport are subject to revision, suspension or revocation without notice. Another section of the regulations dealing specifically with validated licenses provides essentially the same thing.

The key question is, what do these provisions mean in a situation where the export has already occurred? Now, those sections could be read as simply notice to the effect that the Commerce Department reserves the right to move an item from the general license category to the validated license category, and vice versa. That is one reading. With respect to the validated licenses, it could be read as notice that any outstanding validated license can be revoked, suspended on modified.

But an alternative reading of these provisions is that they convey broad authority to revoke any right or privilege, whether derived pursuant to a validated license or a general license, and regardless by whom that right is held, to export, the product of U.S. origin technical data.

Senator **Mathias**. The only parallel that I can think of that applies at all is the situation which you get into if your name ever gets on the roster of a college or a university. You may never have attended a class or you may have been there ever so fleetingly, yet the college or university feels at any time thereafter in your life they can levy on you for a contribution because you have had that passing connection. You never know when the blow will fall or how deep the demand will be.

It is almost that sweeping, isn't it, that if you once have done business in this area you are then subject to this control forever?

Mr. **Marcuss**. There is that flavor, and I suppose the answer is, give early and often, or whatever.

If you think about the question that you suggest, it is obvious that it raises some very, very difficult legal questions, as well as conceptual questions. Let us just start with export licenses. What are they? They are rights or privileges, however one chooses to characterize them, conferred upon exporters, who assume in connection with those rights or privileges certain duties.

However, once an export has been made, an exporter is generally powerless to control the subsequent disposition or use of the export. Of what meaning, therefore, I ask, is it to modify a license under which an export already has taken place? To modify a right or a privilege that has already been exercised does indeed have a faint air of futility about it.

In that connection, I think it is useful to note that validated licenses, since we assume that is what we are dealing with here, validated licenses, are valid generally for only 1 year. So I ask the question, can an expired validated license be revoked, suspended, or modified? I see a faint number of angels dancing on the head of a pin when I ask that question.

It can be argued in response that any foreign company, as you suggest, Mr. Chairman, that acquires U.S. origin goods and technology implicitly subjects itself to U.S. jurisdiction. But that is really quite an extraordinary proposition and undoubtedly would be greeted with some surprise and dismay by foreign importers of U.S. goods and technology.

At the very beginning of the hearing you suggested that it would be quite surprising if someone who bought something 10 years ago suddenly were to discover that he could not make the use of it that he had intended to be able to make.

Senator MATHIAS. Even though that use was perfectly legal or permissible or beyond reproach at the time of the original transaction?

Mr. MARCUSS. That is right. If you think about that, it is a jurisdictional matter to take that position. That would constitute a virtually limitless exercise of U.S. extraterritorial jurisdiction in an ex post facto fashion.

Now, one might argue that the case is different where a foreign importer signs an end use certification pursuant to a validated license application. There I suppose he can reasonably be said to subject himself to U.S. export control restraints with respect to the export in question and in accordance with his own representations.

But he might nonetheless have a strong argument that any agreement to be bound by his representations does not constitute an agreement to be bound by any subsequent restrictions the U.S. may impose, and it most certainly does not constitute an agreement to subject himself to U.S. jurisdiction.

So in sum, while the existing regulations could be read as authorizing some form of ex post facto change in the terms of an export license, the concept has little meaning, I think where the transaction is complete, unless one assumes that the foreign importer takes all U.S. exports subject to whatever restrictions may subsequently be placed upon them. While there may be arguments to support that proposition, it seems to me it is fraught with a great deal of difficulty and should not be embraced unless and until the legal thicket is clarified.

Senator MATHIAS. It would discount the value of U.S. products, too, would it not?

Mr. MARCUSS. It almost assuredly would do that. The question is, what has one bought when one buys technology to produce abroad if at some point the markets that were anticipated to be available as a consequence of having purchased that technology are no longer available to you because of U.S. law?

Yes, it has a significant consequence. Indeed, the consequncee flows both ways, at least conceivably could flow both ways. If there are royalties associated with the sale of technology, the U.S. exporter of the technology might find the value of the sale changed as a consequence of the exercise of extraterritorial jurisdiction.

Of equal difficulty, it seems to me, apart from the sort of quasi-jurisdictional questions is the question of whether the regulations should be applied retroactively under any circumstances. Regulations are constantly being amended. However one interprets the current provisions, what if those provisions were not in the regulations at the time the exports took place?

Let me pass on to the fourth issue which I identified, and that is whether any such effort of the kind we are talking about would be consistent with the statute. Let us leave aside the question of how the regulation should be interpreted and the question of ex post facto applicability, and so forth. Would it be consistent with the statute?

The current act, the Export Administration Act, authorizes the President to prohibit for foreign policy purposes the exportation of any goods, technology, or other information subject to the jurisdiction, or exported by any person subject to the jurisdiction, of the United States. Neither the statute nor the regulations define what is meant by "subject to the jurisdiction of the United States." However, the legislative history makes it reasonably clear that it was intended to confer authority to control non-U.S. origin exports by foreign subsidiaries, only by foreign subsidiaries of U.S. concerns.

There is nothing to suggest a congressional intent to extend the jurisdiction of the act to other foreign entities.

The fifth major issue, Mr. Chairman, is the question of consistency with international law. This is a fairly complicated subject and I propose to pass over it in large part, because it is covered in some detail in my testimony. But suffice it to say it seems to me that the United States as much as any other country has an important interest in seeing that its actions are regarded as being consistent with international law, as vague as international law might be.

Under the protective principle of international law, which I suppose is the most far-reaching principle authorizing the exercise of extraterritorial jurisdiction, it is important that there be a vital interest of a security nature, if you will, of the country that proposes to extend its law that broadly. It seems to me that we need to know and be sure that we are acting within the framework of that principle, or else be prepared to pay the price when other countries say to us that they too can act in disregard of international law because we, the United States, do not value international law very highly.

The last issue I have identified is the question of whether the criteria under the current statute could be met were the President to seek to impose controls of the kind he talked about. Mr. Downey alluded to those before. It seems to me that Congress inserted those criteria for a purpose, a serious purpose.

It is true that the statute requires only that the President consider those factors. It is true that he is free to ignore them. But if this provision of the statute is to be taken seriously—and this provision is the consequence of a great deal of deliberation in 1979 in the Congress, between the Congress and the administration—it is imperative that the legal obligation to consider these factors be enforced.

As a practical matter, this means that should ex post facto controls be imposed on products produced abroad for the Soviet pipeline, it will be imperative for the Congress to probe how carefully the statutorily prescribed factors were considered.

Mr. Chairman, this is a brief sketch of some of the issues involved. Some may regard it as supertechnical and as little more than the gruel upon which lawyers delight. But the issues are serious issues in and of themselves, regardless of one's views on the merits of the pipeline.

How they are resolved will say much about this Nation's commitment to the rule of law.

Thank you, Mr. Chairman.

[Mr. Marcuss' prepared statement follows:]

### PREPARED STATEMENT OF STANLEY J. MARCUSS

Mr. Chairman and Members of the Subcommittee: I am pleased to testify on the legal issues that might arise were the United States to attempt to assert ex post facto foreign policy export controls on products produced abroad with U.S. technology. The issue arises because the Administration is reportedly considering proposals to prohibit one or more European firms from exporting to the Soviet Union, for use in connection with the Soviet-European natural gas pipeline, products produced with technology acquired from one or more American companies several years ago.

My knowledge of these proposals is limited to what I have read in the newspapers. I assume that, at the time the technology was acquired from the United States, there were no constraints on the ability of the acquiring foreign firms to export to the Soviet Union the products produced with or by that technology and that, therefore, the key issue is whether the proposed controls can be applied ex post facto.

At the outset, I should point out that the reported proposals raise many difficult legal issues. The proper resolution of these issues necessarily depends on the particular facts involved. My testimony, therefore, is general in character and is intended only to identify the major legal issues that may be involved. Nor does my testimony deal with the difficult policy questions that the proposals involve, such as what effect any such ex post facto attempt to control the activities of foreign firms might have on their willingness to do business with the United States in the future; whether such attempts might generate retaliatory measures such as blocking statutes; and whether the pipeline would constitute a threat to or an enhancement of Western security. These are important issues but are beyond the scope of my testimony.

The authority that would be invoked to control exports of products produced abroad with U.S.-origin technology would presumably be the Export Administration Act of 1979, 50 U.S.C.A. App. § 2401 et seq. (Supp. 1981). Under that statute, the President is authorized to "prohibit or curtail the exportation of any goods, technology, or other information subject to the jurisdiction of the United States or exported by any person subject to the jurisdiction of the United States, to the extent necessary to further significantly the foreign policy of the United States or to fulfill its declared international obligations." Id. § 2405(a)(1). Pursuant to that authority, the Commerce Department has promulgated an extensive array of regulations (the "Regulations") to control U.S. exports. 15 C.F.R. §§ 368-399.2.

The major legal issues as I see them are as follows:

1. Do the current Regulations prohibit foreign exports of the type in question?
2. If they do, can they be applied today if the original export of U.S. technology was pursuant to a different set of regulations?
3. If the current Regulations do not authorize controls over foreign exports of the type in question, can they be amended to apply retroactively?
4. Would an effort to reach the foreign exports in question be consistent with the Export Administration Act of 1979 or the version of that statute in effect at the time of the original export of the technology from the United States?
5. Would an ex post facto effort to restrict the exports of foreign-made products using previously exported U.S. technology be consistent with international law?
6. Would the proposed controls meet the criteria specified in the Export Administration Act of 1979?

Under these broad headings there are numerous sub-issues, some of which will emerge from what follows.

Turning to the first issue:

1. Do the current Regulations authorize controls over foreign exports of the type in question?

Section 379.8(a) of the Regulations provides that, unless specifically authorized by the Office of Export Administration, or otherwise authorized under the provisions of § 379.8(b) of the Export Administration Regulations, "no person in the United States or in a foreign country may export or reexport to . . . [the Soviet Union] . . . any foreign produced direct product of U.S. technical data, or any commodity produced by any plant or major component thereof which is a direct product of U.S. technical data, if such direct product or commodity is covered by the provisions of §379.4(f) or §379.5(e) (1) or (2)." 15 C.F.R § 379.8(a). Thus, on their face, the Regulations purport to restrict the ability of a foreign company to export the "direct product" of U.S. origin technical data and any commodity produced by any plant or major component thereof which is itself the "direct product" of U.S. origin technical data if such direct product or commodity is covered by certain designated provisions of the Regulations unless (a) the export is specifically authorized by the Office of Export Administration or (b) the export is otherwise authorized under § 379.8(b) of the Regulations.

The first question then is whether the products to be produced abroad and exported to the Soviet Union are of a type covered by the designated sections of the Regulations, namely, §§ 379.4(f) or 379.5(e) (1) or (2). Among the products listed under § 379.4(f) are "machinery, equipment, instruments and other commodities utilized for the exploration, production, transmission or refinement of petroleum or natural gas up to and including refinery operations directed to energy usage but excluding petrochemical feedstock processes." 15 C.F.R. § 379.4(f)(1)(p). Assuming that the products in question are to be utilized for the transmission of natural gas to be used for energy purposes rather than for petrochemical feedstock purposes, they would appear to be covered by the Regulations. Some of the products described under § 379.5(e) (1) and (2), such as pipe fittings and heat exchangers made of stainless steel, might also be involved.

The second question is whether the products or commodities involved are the "direct product" of U.S.-origin technical data or produced by a plant or major component thereof which is itself the direct product of U.S.-origin technical data. Unfortunately, the term "direct product" is not specifically defined for purposes of this section of the Regulations, although for purposes of other sections of the Regulations it is defined as "the immediate product (including processes and services) produced directly by use of the technical data." See 15 C.F.R. §§ 379.4 (e) fn. 5 and 379.4(f)(1) fn. 6.

Assuming that this definition applies to the case at hand, the question is whether the products at issue constitute the immediate product of the technical data or a product of a factory or major component thereof which itself is the immediate product of U.S. technical data. For example, if the product were a valve manufactured with specialty metals produced with U.S. technology, it might very well not constitute the direct product of U.S. technical data within the meaning of the Regulations since it would be once removed from the immediate product of the technology.

The third question under the first major issue is whether export of the foreign-produced product of U.S. technical data is "otherwise authorized" under § 379. 8(b) of the Regulations. Under subparagraph (3) of that section, authorization from the Commerce Department to export the foreign-produced direct product of U.S. technical data is not required if the product is of type controlled by COCOM, has been approved for export by COCOM and meets a number of other highly technical requirements as specified in that paragraph. And under subparagraph (2) of § 389.8(b) of the Regulations, reexports of technical data to a third country are permitted if, at the time of export, the technical data may be exported from the United States to that country under a general license. It would follow that the product of such data could similarily be exported.

Therefore, the question of whether the current regulations restrict the export of the products in question basically turns on the specific identity of the product involved, whether it is the "direct product" of U.S. technology or the product of a factory or machinery that is the "direct product" of U.S. technology, whether it is an item controlled by COCOM and whether the technology involved may be exported to the Soviet Union under general license.

The next two issues can be combined for purposes of analysis:

2. If the current Regulations prohibit exports to the Soviet Union of the products involved, can they be applied today if the original export of the technical data was pursuant to regulations that did not prohibit such exports?

3. On the other hand, if the current Regulations permit the exports in question, can they be amended to apply retroactively?

Both questions involve the issue of the ex post facto application of U.S. law.

Analytically, it is useful to distinguish between technical data that has been exported pursuant to a general license and technical data that has been exported pursuant to a validated license.

Under the general scheme of the Regulations, all exports from the United States take place pursuant to either a general license or a validated license. A general license is one established by the Commerce Department for which no application is required and for which no document is granted or issued. 15 C.F.R. §§ 370.2 and 371.1. A validated license, on the other hand, is a document issued by the Department of Commerce authorizing a specific export. 15 C.F.R. §§ 370.2 and 372.2.

If the technical data used abroad to manufacture products for the natural gas pipeline had been exported pursuant to a general license, there would have been no restrictions at the time on its reexport or on the export of the products of that data. Even if the technical data had been exported pursuant to a validated license, there may well have been no restrictions on reexport to the Soviet Union of the product of that data. The latter is a question of fact that would need to be examined.

Section 370.3 of the Regulations provides that "all export licenses and other authorizations to export or reexport are subject to revision, suspension or revocation without notice." Section 372.9(d)(4) of the Regulations, dealing with validated licenses, provides that "outstanding licenses may be revised, suspended or revoked, or the validity periods thereof extended or reduced, by appropriate orders or regulations." The key question is what do these provisions mean in a situation where the export has already occurred?

Section 370.3 could be read simply as notice to the effect that the Commerce Department reserves the right to move an item from the general license category to the validated license category and vice versa. Section 372.9(d)(4) could be read as notice that any outstanding validated license may be revoked, suspended or modified. An alternative reading of these provisions is that they convey broad authority to revoke any right or privilege, whether derived pursuant to validated or general license and regardless by whom it is held, to export the product of U.S.-origin technical data.

The latter interpretation, however, raises a number of difficult legal and conceptual issues if applied to completed export transactions. Export licenses are rights or privileges conferred upon exporters who assume in connection therewith certain duties. However, once an export has been made, an exporter is generally powerless to control its subsequent disposition or use. Of what meaning is it, therefore, to modify a license under which an export has already taken place? To modify a right or a privilege that has already been exercised has a faint air of futility about it. In that connection, it is useful to note that validated licenses are generally valid for only one year (15 C.F.R. § 372.9(d)(1)). Can an expired license be revoked, suspended or modified?

It can be argued in response that any foreign company that acquires U.S. origin goods and technology implicitly subjects itself to U.S. jurisdiction. But that is quite an extraordinary proposition and undoubtedly would be greeted with some surprise and dismay by foreign importers of U.S. goods and technology. The notion that foreign importers of U.S. goods and technology are subject to whatever subsequent constraints that United States may impose on their use would constitute a virtually limitless exercise of U.S. extraterritorial jurisdiction. One can imagine the response of a French truck axle manufacturer who ten years ago purchased U.S. technology to manufacture those axles were he to be told today that he can no longer export those axles as he had assumed at the time of his purchase.

The case is, of course, different where a foreign importer signs an end-use certification making representations as to the use to which the U.S. import will be put. There he can reasonably be said to subject himself to U.S. export control constraints with respect to the export in question and in accordance with his representations. But he might, nonetheless, have a strong argument that any agreement to be bound by his representations does not constitute an agreement to be bound by any subsequent restrictions the United States may impose on the product that he acquired.

In sum, while the existing Regulations could be read as authorizing some form of ex post facto change in the terms of an export license, the concept has little meaning where the export transaction is complete unless one assumes that the foreign importer takes all U.S. exports subject to whatever restrictions may subsequently be placed upon them. While there may be arguments to support the latter proposition, it is frought with difficulty and should not be embraced unless the legal thicket it suggests is clarified.

Of equal difficulty is the question of whether the Regulations should be retroactively applied under any circumstances. The Regulations are constantly being amended. However one interprets the provisions which state that licenses may be revoked at any time, what if those provisions were not in the Regulations at the time the exports of U.S. technology occurred? (I note parenthetically that it was not until July of 1981 that validated export licenses bore the legend: "This license is subject to revision, suspension or revocation without prior notice.") Might not such circumstances raise questions of due process?

4. A fourth major legal issue is whether any regulation that attempted to reach exports already made would be consistent with the statute. Put another way, assuming that the current regulations permit ex post facto control of products produced with previously exported U.S. technical data or that if they don't, they were to be amended to do so, would any such amendment or application of existing regulations be consistent with the statute?

As indicated at the outset, the Export Administration Act authorizes the President to prohibit or curtail for foreign policy purposes the "exportation of any goods, technology, or other information subject to the jurisdiction or exported by any person subject to the jurisdiction of the United States." 50 U.S.C.A. App. § 2405(a)(1) (Supp. 1981).

Neither the statute nor the Regulations define what is meant by an export subject to the jurisdiction of the United States or made by a person subject to the jurisdiction of the United States. However, the legislative history of this phrase makes it clear that it was inserted into the Export Administration Act in 1979 in order to confer authority to control non U.S.-origin exports by foreign subsidiaries of U.S. concerns. Public Law 95–223, § 301(a), 91 Stat. 1629. *See* S. Rept. No. 95–466, 95th Cong. 1st Sess. 6 (1977). There is nothing to suggest a Congressional intent to extend the jurisdiction of the Act over other foreign entities. Accordingly, to the extent that ex post facto controls over technology in the hands of foreign firms is tantamount to an exercise of jursidiction over those firms, there may be some question as to whether that is a permissible exercise of statutory authority. Moreover, it is interesting to note that, prior to 1979, the authority to control exports under the Export Administration Act was expressed as authority to control exports "from the United States, its territories and possessions." This could be read as a limitation on the ability of the President to control exports from foreign countries except as may be incident to the terms of an export license. If so, it could be argued that exports that took place under that statute cannot be governed by a subsequently enacted statute.

5. The fifth major issue is whether an ex post facto effort to restrict foreign-made products using previously exported U.S. technology is consistent with international law.

The question of what circumstances justify the exercise of extraterritorial jurisdiction under international law is exceedingly complex and cannot be treated in detail here.[1] For present purposes, it suffices to begin with the proposition that any excercise of extraterritorial jurisdiction must have a healthy respect for the sovereignty of other nations. Any attempt by the United States to dictate the commodities that may or may not be exported from another country with an export policy different from our own runs a significant risk of impermissible interference with that country's sovereign rights. Only a strong countervailing interest of the United States in applying its law can outweigh this risk.

Of the five principles identified with some frequency by international legal scholars in support of exercises of extraterritorial jurisdiction,[2] none receives unanimous support. The "protective principle" has won substantial acceptance, however, and appears most relevant to the present discussion.

The theory of the protective principle is that a country may punish acts committed by aliens in foreign countries where those acts diminish the security, territorial integrity or political independence of that country.[3] However, even where extraterritorial jurisdiction is justified under this principle, some limits must be observed; an infinite variety of acts abroad may affect the security of another country, yet if every such act justified a trespass upon the sovereignty of a foreign state, extraterritorial jurisdiction would quickly get out of hand. In the context of international trade, only those transactions that genuinely and directly affect the security of the United States—as opposed to transactions that merely create inconveniences or even reverses for U.S. foreign policy—arguably provide a legitimate case for assertion of extraterritorial jurisdiction under the protective principle.

In the context of export controls, COCOM theoretically provides a mechanism for minimizing inconsistencies among the allies. Export controls imposed extraterritorially by the United States for purposes of foreign policy would not intrude unjustifiably on European sovereignty so long as they are confined to goods and technology that the COCOM countries agree to restrict. It is evident in the pipeline controversy, however, that our allies do not see eye-to-eye with the United States on the necessity of limiting trade in goods and technology that may contribute to the construction of the pipeline, so that conflicts of policy are clearly present.

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[1] For a more detailed analysis of this question in the context of national security and "Extraterritorial Jurisdiction in U.S. Trade Laws: The Need for a Consistent Theory," foreign policy export controls as well as other U.S. trade laws, *see* Marcuss and Richard, Col. J. Transnat'l L. (1982) (publication pending.)

[2] These are the "territorial principle," holding that nations generally have jurisdiction to prescribe rules as to acts or omissions occurring within their own territory, and, in at least some cases, those having effects within their own territory; the "nationality principle," under which nations have jurisdiction to prescribe rules of conduct for their nationals even if they are outside their home country; the "passive personality principle," holding that nations may punish aliens for acts abroad that are harmful to nationals of the acting country; the "universality principle," which recognizes jurisdiction on the part of a country to punish acts of aliens where the acts and the surrounding circumstances are such as to justify punishment as a matter of international public policy; and the "protective principle," discussed above. *See* Marcuss and Richard, supra.

[3] The Harvard Law School Research in International Law, "Draft Convention on Jurisdiction with Respect to Crime, with Comment," 29 Am. J. Int'l. L. (Supp. II) 439, 440 (19—).

I assume that the U.S. Government has made detailed factual assessments of the likely impact on U.S. security of the construction of the Soviet-European pipeline. But if those dangers to U.S. security are merely general and speculative or indirect, then the protective principle may not provide firm ground on which to defend proposals to exercise extraterritorial jurisdiction in connection with that pipeline. Each sovereign state in Europe also has a right to assess the risks and rewards of entering into the pipeline transaction.

It is essential to consider this problem carefully, because in the long run, the United States is bound to pay a price if it exceeds the limits imposed upon extraterritorial jurisdiction by international law. Whether this price takes the form of statutes adopted by our allies to frustrate our laws, or of diminished cooperation in COCOM or other bodies, we should not pay that price unknowingly.

6. A sixth major issue is whether the criteria that the President must consider under the Export Administration Act when imposing, expanding or extending foreign policy export controls can honestly be met.

Under the Act, when imposing, expanding or extending foreign policy export controls, the President is required to consider and to report to Congress on the following:

> (1) The probability that such controls will achieve the intended foreign policy purpose, in light of other factors, including the availability from other countries of the goods or technology proposed for such controls;
>
> (2) The compatibility of the proposed controls with the foreign policy objectives of the United States, including the effort to counter international terrorism, and with overall United States policy toward the country which is the proposed target of the controls;
>
> (3) The reaction of other countries to the imposition or expansion of such export controls by the United States;
>
> (4) The likely effects of the proposed controls on the export performance of the United States, on the competitive position of the United States in the international economy, on the international reputation of the United States as a supplier of goods and technology, and on individual United States companies and their employees and communities, including the effects of the controls on existing contracts;
>
> (5) The ability of the United States to enforce the proposed controls effectively; and
>
> (6) The foreign policy consequences of not imposing controls. 50 U.S.C.A. App. § 2405(b) (Supp. 1981)

While it is true that the statute requires only that the President "consider" these factors and that he is free to ignore them after considering them, they were placed into the law in 1979 because of Congressional concern that foreign policy export controls were being exercised too frequently and without adequate thought. If this provision of the statute is to be taken seriously, it is imperative that the legal obligation to consider the specified factors be enforced. As a practical matter, this means that should ex post facto controls be imposed on products produced abroad for the Soviet pipeline, it will be imperative for Congress to probe how carefully these statutorily prescribed factors were considered.

This testimony is but a brief sketch of some of the issues involved. Some may be regarded as super-technical and as little more than the gruel upon which lawyers delight. But the issues are serious issues in themselves whatever one's views on the merits of the pipeline. How they are resolved will say much about this Nation's commitment to the rule of law.

Senator **Mathias**. Thank you very much. Mr. Rosenthal.

## STATEMENT OF DOUGLAS E. ROSENTHAL, ESQ., SUTHERLAND ASBILL & BRENNAN

Mr. **Rosenthal**. Thank you, Mr. Chairman. I will focus on three points in my oral remarks.

The first is there have been some important developments in the foreign relations law of the United States since some of the thinking that underlies the 1979 Export Administration Act was done, and the legislative history of the predecessors to the 1979 act was written. There is a need for reconciling, for bringing that jurisprudence and that law directly into play in interpreting the Export Administration Act.

The second point I would like to make is that I think we are not just talking here about international law or the proper construction of the Export Administration Act, but I think it is terribly important to reverse our focus and ask, how would we feel under U.S. law if a foreign nation were making the same demands upon our companies and our citizens that it is contemplated, apparently, we would make upon the citizens and companies of foreign countries? I think the answer to that question has a direct bearing on whether our law is properly interpreted.

The third point I want to make is, given the asymmetry between existing jurisprudence and some present claims for how the U.S. export and transaction control laws should be applied, given the asymmetry between the way some people view what is appropriate for us to do to reach abroad and what is inappropriate for other sovereigns to do to reach into our jurisdiction, there really is a need, Mr. Chairman, for a comprehensive review of this extraterritoriality problem.

The themes do transcend particular substantive areas of law, like antitrust or export control or securities law or proper rules of discovery in our Federal court system. They are common themes that we come back to again and again. We need a fresh and comprehensive overview, so that we can remove these asymmetries, have a consistent position which supports U.S. interests and which can be consistently applied throughout our legal regime.

On the first point, I suppose the high water mark of export and transaction control enforcement was the early sixties, as in the *Fruehauf* case that was mentioned by my colleague Art Downey. In 1965, the American Law Institute issued a Restatement of the Foreign Relations Law of the United States.

In that Restatement it was said that in applying U.S. law—and while the issue was not specifically addressed to the best of my recollection, I assume it refers also to the application of laws like U.S. export control laws—in the application of U.S. law, restraint should be exercised, so that when the application of U.S. law brought one into conflict with the application of the sovereign laws of sister sovereign jurisdictions, we would not be acting without due regard under a principle of comity for the sovereign status of a coequal sister nation.

But what is important about the 1965 Restatement is it was purely discretionary. There was no legal obligation on the United States to apply U.S. law consistent with conflicts of laws principles.

Subsequently, though, there have been some decisions by the courts, most notably in the antitrust area in the *Timberlane* case, but there have been similar decisions in other areas of law as well. The point I make in my testimony, Mr. Chairman, is this: If it is contended the jurisdictional reach, the extraterritorial jurisdictional reach of the export control law is as broad as possible and therefore precedent from private law and other statutes should not be regarded. Let me remind those who would make that argument that there are some court precedents and congressional legislative history which says that the Sherman Act and the antitrust laws are about as broad in their jurisdictional scope, including their extraterritorial jurisdictional scope, as any law any Congress in our history ever has passed.

In the 1976 *Timberlane* case, the Ninth Circuit, with the Supreme Court denying certiorari on appeal, the Ninth Circuit said it is a legal obligation under U.S. law to balance sovereign national interests. The Sherman Act does not authorize its application in a circumstance where to apply it would be outweighed by the legitimate interests of foreign sovereigns with conflicting and overriding concerns sovereign under their law, where the U.S. contacts with the transaction were predominantly outweighed by application of the interests under the foreign law.

The second development we have seen since that high-water-mark period is the end to a sharp distinction between public and private international and foreign relations law. In the interim we have seen governments involve themselves increasingly directly in international trade and commerce. We have seen in the Soviet bloc and in some Third World countries state trading companies involved in commercial transactions, seeking sovereign immunity for their commercial activities if they choose not to honor commercial obligations that private firms would have to undertake.

This Congress, with the work of this committee and others, in 1976 passed a Foreign Sovereign Immunities Act which clarified that governments, that public law, was subject to a discipline when we had mixed questions of public and private law, mixed questions of political and commercial law. That development, it seems to me, is an important development, in light of which the proper application of the export control regulations must be taken into account.

Mr. Chairman, there is currently going on an important new exercise by the American Law Institute to codify and clarify these developments and establish a new assertion of what United States foreign relations law should be. This exercise is in progress. It is not binding directly as law. But I think we have found from history that what is concluded out of that deliberation often has a powerful influence on the way our law develops.

I can tell you that the direction of that exercise at present is that laws such as the export administration laws should be subject to a rule of reasonableness, that it is inappropriate to apply extraterritorial sanctions if those sanctions cannot be justified under international conflicts of laws principles.

Let me turn to the second point: Would we stand for a similar application of foreign sovereign law applied to us? What, in fact, I would like to do is to try to reorient the thinking of a number of people whose attitude about U.S. extraterritoriality always has been premised on the assumption that we will be the ones to apply our laws vigorously extraterritorially and we can count on others not to apply their laws in the same way against us.

Let us think a minute about what kind of chaos there would be in international trade if other nations took a lesson from our book and applied their laws as aggressively against us. We have in fact, Mr. Chairman, already seen one example of it and we do not like it, and that, of course, is the Arab boycott of those persons which are considered to be too friendly in trading with Israel.

Assume that the new French Government became convinced that the military junta in Chile or some other country was an implacable enemy of their people. It is not an altogether implausible assumption.

Assume further that French companies—and I am now trying to get a mirror image of what we are talking about going abroad—that French companies had licensed important technology to certain unrelated U.S. companies, and that the French Government was now threatening these U.S. companies with severe sanctions under French law if they honored contracts for the sale of U.S.-made goods.

There is talk—we have seen it reported in the paper—of even arresting the officers of foreign companies, if they ever visit the United States, if they proceed with the sales of products made with antecedent U.S. technology to the Soviet pipeline. Can one seriously believe that this administration for the majority of the American people would tolerate such a French dictate?

The point has been made that there is authority under our export control laws for the application of these laws to reach the foreign subsidiaries of the U.S. parent corporations. Well, let us consider that example. What if the American Motors Corp. which is now an affiliate and perhaps a subsidiary of the French enterprise Renault was ordered by the French Government not to export 10,000 cars to Chile which it was contractually required to sell and as to which export financing had been obtained from the U.S. Government's Export-Import Bank?

Would the U.S. Government acquiesce in this French order? Would the American Motors Corp. be free from legal liability for damages and a breach of contract action brought in a U.S. court by the Chilean purchasers? Would the United Auto Workers accept the loss of 500 jobs because the purchase order could not be filled due to the operation of French law?

It seems to me, Mr. Chairman, that if the answer to those questions is, or could be, no, it should give us considerable pause before we consider the application of U.S. law to do the mirror image of that kind of conduct to our most trusted and important allies in meeting the Soviet challenge abroad.

Exactly 3 months to the day, I had the opportunity and the pleasure to appear before you while you were wearing your hat as an important senior member of the Senate Judiciary Committee, where we were considering your bill, S. 432, to establish a Presidential commission for the review of the antitrust laws and for a review, among other things, of the extraterritoriality problems that it has been claimed U.S. antitrust laws pose for the American business community.

Mr. Chairman, because you are an expert on this subject you will recognize, and others may be interested to know, that many of the same issues and many of the same concerns that were raised in that hearing and that you have been aware of as you have championed this legislation now for several years, raised entirely in a context apart from East-West trade, are the same considerations that we are talking about today in the context of East-West trade and the context of export controls.

Mr. Chairman, if we were to take the field of securities law and the issue of how broadly do our securities law reach to protect shareholders outside our territorial jurisdiction, what rights are created for foreign shareholders to sue for fraud under our laws, what are the obligations under U.S. antifraud laws of officers and directors of foreign corporations with only relatively few contacts in the United States, we would find exactly the same issues in that area as well.

There are a variety of other fields of law—environmental law, energy law, commodities futures trading, and I could add a list up to about 20, including banking law, insurance law, and others and on and on—where many of these same issues would be raised if one were to look at the implications of U.S. extraterritorial assertions of jurisdiction.

There is a need for a coordinated focus. As I understand it, this administration is reluctant to encourage the Senate to call for a Presidential review of these questions or a review by a non-Presidential commission, because the administration, like all administrations—and I think Stan Marcuss and I can speak from personal experience—do not like the idea of these issues being open to public scrutiny before the administration has worked out its position.

But Mr. Chairman, that is entirely the point. This administration has not worked out a consistent position over this range of laws. There is a variety of separate jurisdictions and separate interests within our current administration. It was this way in the prior administration, in the administration before that as well. This is a phenomenon which goes back into our history.

There really now is a need for a review and a pulling together. I believe that an expansion of the scope of the work of a commission of the type you propose in S. 432 to include the subject we are considering today is highly important and ought to go forward. I would hope that this committee and its staff would look very sympathetically at trying to assist the passage of this legislation.

Thank you very much, Mr. Chairman.

[Mr. Rosenthal's prepared statement follows:]

### PREPARED STATEMENT OF DOUGLAS E. ROSENTHAL, ESQ.

I am Douglas Rosenthal, a partner in the law firm of Sutherland, Asbill & Brennan here in Washington, speaking to you today as an individual with experience in the extraterritorial application of United States law.[1] I appreciate the Committee's invitation to address the implications, under United States and international law, of United States export control restrictions which may soon be imposed on foreign persons and enterprises. Foreign companies and individuals may be punished under U.S. law if they use technology previously furnished by American firms, technology which was legally licensed under U.S. law in effect at the time of its transfer. This technology is, purportedly, indispensible in the production of equipment for sale to the Soviet Union. The Russians will use it in constructing an important natural gas pipeline from Western Siberia to Western Europe.

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[1] My views are personal and do not necessarily represent those of my partners, our clients or any organization with which I am involved. From 1974 to 1980, I served under five Attorneys General, of both political parties, as an official responsible for the enforcement of antitrust law in United States foreign commerce. At present, I am Chairman of the Committee on the Extraterritorial Application of United States Law of the American Bar Association's International Law Section and Chairman of the Antitrust Working Group of the Export Policy Task Force of the United States Chamber of Commerce.

On January 5, the Department of Commerce issued regulations, pursuant to the Export Administration Act of 1979, expanding existing oil and gas controls applicable to the Soviet Union to include, among other things, technical data for the transmission of natural gas. These new regulations were an explicit response "to the Soviet Union's heavy and direct responsibility for the repression in Poland." According to press reports,[2] some foreign policy officials in the Administration are advocating an expansion of these January 5 regulations, by interpretation or amendment, to threaten French, German, Italian and British corporations and officials with criminal sanctions under U.S. export control law if they manufacture components and use those components to assemble turbines for the pipeline.

The foreign companies potentially subject to U.S. enforcement are already obligated to make and deliver these turbines under contracts entered well before January 5th. At the time the contracts were entered, I understand, U.S. licensors were told that the use of such technology was legal and the U.S. licensors themselves were even then assured that they could manufacture and export components, such as turbine rotors, from the United States.

Under the January 5 regulations, the U.S. licensors are now clearly prevented from supplying in the future either goods or technology that will assist construction of the pipeline. There is no issue about the legality of this restriction—even if there is reason to doubt its wisdom. The basis for now asserting control over the foreign firms would be that much of the technology they would use will have come from American licensors, the General Electric Company and Howmet Turbine Components Corporation, well before 1982, pursuant to license agreements going back several years. Such an assertion of control raises very substantial legal issues.

I do not know precisely what type of technology is involved. Is it primarily basic blueprints, specifications, and patentable processes? Is it the skilled know-how of senior technicians who substantially refresh their knowledge by regular on-sight inspections of licensor plants in the United States? These factual questions could make a difference in a close case.

I am also uncertain about the legal obligations created by the license agreements. An editorial in the Wall Street Journal[3] suggests that the license agreements "already provide that the licensee will be bound by United States government export regulation." I understand that that may not be true as to all relevant license contracts. Of course, even as to contracts in which such a clause may be found, it is by no means obvious that it was intended to apply to limit the future use of technology which was properly licensed under U.S. Government export regulations at the time it was exported.

In general, contract provisions, under both U.S. and foreign law, are construed in terms of the reasonable expectations of the contracting parties. It seems dubious to read the provisions paraphrased by the Wall Street Journal to give the U.S. licensor a "perpetual veto" over futher use of the technology in anticipation of possible future U.S. export controls. It is even more doubtful that such a private contractual right by itself can validate, as a matter of law, any new, not easily anticipated, U.S. controls over the foreign licensee.

The facts are unclear, and the claims of legality by proponents are sweeping. In this circumstance it is easy for non-lawyers to be confused about the rights and wrongs. To add to the uncertainty, it is reported that some lawyers in the Administration have concluded that there is an insufficient legal basis for applying U.S. export control law to frustrate the contracts the European licensees have undertaken. The bases for their conclusion have not been published and we are unlikely to learn them unless and until their view prevails.

Nonetheless, based on the facts as I have outlined them, these lawyers are correct. It is improper as a matter of U.S. law and international custom to seek to control European firms in the manner proposed. Even if there were no important economic and political policy reasons for opposing such excessive extraterritorial interference with the vital sovereign interests of four of our closest allies and trading partners, which there are, and which others today are addressing, enforcing such controls would be wrong as a matter of law.

The Export Administration Act has traditionally been interpreted by U.S. Government officials to give them control over commodities originating in the United States. Technology too is subject to control. Even if only a small part of the technology incorporated in foreign-made products originates in the United

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[2] See e.g. The Washington Post, January 31, 1982, pages A1 and A6.

[3] Feb. 4, 1982.

States, under this traditional view, that gives the United States sufficient control over the export of goods from their foreign place of manufacture or assembly. This Act also authorizes U.S. control of the disposition of goods by any person "subject to the jurisdiction of the United States." The fundamental issue then is does the United Sdtates, on the given facts, have jurisdiction under the Act, over French, German, British and Italian companies?

Congressional intent with respect to proper exercise of jurisdiction by the Executive Branch is not crystal clear. Since the end of World War II, Congress has implicitly acquiesced when various administrations have asserted export controls over U.S. persons transferring technology without authorization to foreign companies, with reason to know that those foreign companies would employ that technology in the sale of goods to controlled countries. This is almost certainly proper.[4]

Furthermore, the Act has been applied to reach foreign companies which re-exported U.S. technical data in breach of an export license granted only on condition of no unauthorized re-export. After one such case, the U.S. licensor successfully sued the foreign licensee in a private damage action and established personal jurisdiction over the foreign firm based on the conduct within U.S. territory of substantial negotiations and disclosure of proprietary know how pertaining to the contracts in question.[5] For a variety of reasons, the jurisdictional validity of these enforcement actions have never been tested by a U.S. court so it cannot be said with certainty that in even these cases the government properly exercised jurisdiction.

In at least one instance, in 1965, Executive Branch enforcement under the sister transaction control law, the Foreign Assets Control Regulations, was excessive. The U.S. Treasury Department ordered Freuhauf-United States not to permit its French subsidiary, Freuhauf-France, to sell truck parts in France for later assembly and shipment to the Peoples Republic of China. The French Government wanted the French subsidiary to fulfill the contract. American and French businessmen were threatened with prison if they did not comply with mutually incompatible legal orders. After a French court put the French company under the control of a temporary administrator who was directed to perform under the contract, the United States backed down.[6]

In the Export Administration Act, Congress intended to authorize, in appropriate cases, a broad exercise of U.S. extraterritorial legal jurisdiction to control the re-export of U.S. technology. But the legislative history does not indicate that Congress wrote a blank check. Congress did not say, "You, the Commerce Department, can apply U.S. law to the outermost limits of our Constitution in any case you believe foreign policy considerations justify, regardless of the consequences of that application, regardless of whether other nations' sovereign laws must be overridden in the process, and regardless of what United States law would say if the situation was reversed." The most sensible construction of the jurisdictional clause of the Act is that it is to be read to be consistent with the principles of jurisdiction, including conflict of laws principles, applied by U.S. courts when U.S. extraterritorial enforcement is sought in litigated cases.

This jurisdictional principle is set forth in the *Timberlane* case decided by the 9th Circuit in 1976.[7] In that case, the court found that the proper application of the Sherman Act, which has perhaps as broad a jurisdictional reach as any legislation ever passed by Congress, was to be limited by a proper balancing of sovereign national interests. Where the United States interest in having U.S. antitrust law applied directly conflicted with the interest of a foreign sovereign in having its important contrary law applied, the statute did not authorize an assertion of U.S. extraterritorial jurisdiction if United States interests did not outweigh the interests of the foreign sovereign. Principles of statutory construction compel a reading of U.S. statutes consistent with this conflict of laws principle, "unless such construction is not fairly possible".[8]

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[4] See for example the 1962 Consent Order in "Hydrocarbon Research, Inc.," 27 Fed. Reg. 12487.

[5] *Halcon International Inc.* v. *SNAM Progetti* SpA ANIC SpA. See Lowenfeld, "Trade Controls for Political Ends" (1977) footnote R, p. 45.

[6] For a criticism of this U.S. enforcement with which I substantially agree see Lowenfeld, "Public Law in the International Arena: Conflict of Laws, International Law, And Some Suggestions For Their Interaction," Vol. 163, "Recueil des cours," p. 315, 335 (1979).

[7] *Timberlane Lumber Co.* v. *The Bank of America*, 549 F.2d 597.

[8] See e.g. § 403 Limitations on Jurisdiction to Prescribe, Tentative Draft No. 2, the American Law Institute Revised Restatement of the Foreign Relations Law of the United States, March 27, 1981.

The governments of France, England, West Germany and Italy, as the governments of virtually all of our major free world allies, generally limit the application of their national laws, even their export control laws, to reach only persons and conduct within their borders. There are, I believe, circumstances under which even these nations have adopted laws conferring extraterritorial jurisdiction and have applied those laws to reach conduct and nationals beyond their border. However, these instances are relatively rare. They usually involve three situations not present with respect to technological transfers relating to the Russian pipeline:

1. There is a hot war in progress so that more is at stake than mere "foreign policy considerations";
2. The person abroad is an individual who is a national of their country bound by obligations of citizenship to respect their law; and
3. There is substantial extrinsic evidence that the extraterritorial conduct was undertaken willfully to evade their national jurisdiction.

If all of these factors were present, or even one or two of them, international custom and conflict of laws principles might justify the unilateral assertion of U.S. jurisdiction. But they are not present.

The justification for the proposed application of these new regulations is to punish the Soviet Union for the Polish suppression. We deplore that totalitarian act but we are not willing to go to war for it. In fact, to counter this aggression, we are not even willing to assert a full measure of legal U.S. territorial controls, which would not conflict with the laws of any of our allies, such as the adoption of an embargo of U.S. sales of grain to the Soviet Union.

Furthermore, the foreign companies to which U.S. law would apply are business entities, not natural persons, formed under the local laws of their home countries. They are not even foreign subsidiaries of U.S. parent corporations, arguably a type of "corporate national" of the United States.[9]

Additionally, there is no reported evidence that the technology which has already been transferred to the foreign companies by the U.S. licensor was transferred with an intention to frustrate or evade U.S. law. At the time of transfer U.S. law permitted the transfer.

We are not just talking here about international custom or international law. If the facts were altered, I think we would be talking about U.S. law as well. Assume, for example, that the new French Government became convinced that, say, the military junta in Chile was an implacable enemy of French socialism and the French people. Such a response is not altogether implausible, especially if a few Chile-related acts of terrorism, like the assassination of Orlando Letelier, were to occur in Paris.

Assume, further, that some French companies had licensed important technology to certain unrelated U.S. companies years ago and that the French government was now threatening these U.S. companies with severe sanctions under French law if they honored contracts for the sale of U.S.-made goods, manufactured in part based on this technology, to Chilean companies. There is, today, talk of the United States Government blocking any transactions between American companies and European firms if these European licensees sell to the Soviets. There is also talk of arresting the foreign officers of these companies if they ever visit the United States.[10] Can one seriously believe that this Administration or the majority of the American people would tolerate an analogous French dictate? Would we tolerate the possibility that an American corporate executive or trade union leader would be faced with possible arrest if he traveled to France on holiday because his company honored a contract to ship American made goods to Chile as the American Government expected it to do? I think not. I don't even think we would tolerate an effort by the French Government to prevent exports to Chile by an American subsidiary of a French parent corporation.

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[9] While I understand that the January 5th regulations may be used to reach some foreign subsidiaries of some U.S. parent corporations, and that too is probably unjustified as a matter of U.S. law, an analysis of those jurisdictional claims is beyond the scope of my testimony today. While drafting the Export Administration Act of 1979, the Senate Committee on Banking, Housing and Urban Affairs considered an amendment to prohibit imposition of new controls on non-U.S. origin exports of foreign subsidiaries of U.S. companies, except in declared international economic emergencies. The State Department submitted a note recommending against including the amendment in order to retain flexibility of action. In discussing the amendment the Committee stated:

"If Congress wishes to attempt to exert control in particular situations over wholly foreign exports of foreign subsidiaries of U.S. firms, Congress can do so by statute in the future as it has done in the past. S. Rept. No. 96–169, 96th Cong., 1st Sess. 5 (1979)."

Significantly, the Committee also recognized that claims of U.S. jurisdiction over such exports by foreign subsidiaries could be expected to be challenged by the foreign governments concerned. Nevertheless, the amendment was withdrawn pending further study of the issue. The most one can conclude from this is that Congress has not yet spoken precisely about the limits of proper assertions of jurisdiction over foreign subsidiaries; but it deserves reemphasis that foreign subsidiaries are not involved in what we are talking about today.

[10] The Washington Post, Jan. 31, 1982, p. A6.

What if American Motors Corp., a U.S. affiliate of the French enterprise Renault and an arguable "corporate national of France", was ordered by the French Government not to export 1,000 cars to Chile which it was contractually required to sell and as to which export financing had been obtained from the U.S. Government's Export-Import Bank? Would the U.S. Government acquiesce in this French order? Would the American Motors Corp. be liable for damages in a breach of contract action brought in a U.S. court by the Chilean purchasers? Would the United Auto Workers accept the loss of, say, 500 jobs because the purchase order could not be filled due to the operation of French law?

The jurisdictional scope of the Export Administration Act must, if we are to avoid hypocrisy and a breakdown in our trading relationships and political alliances, be read as imposing limits consistent with the principle of comity, of reasonableness, of a proper balancing between conflicting national laws. How else can we make any sense of another important part of the Export Administration Act, the foreign boycott provisions? The Act does not just authorize U.S. extraterritorial trade controls in certain circumstances. It requires, under criminal penalty, that U.S. persons not comply with certain foreign export controls imposed by foreign nations seeking to implement foreign policy considerations, vital to them, at our expense.

If Congress intended the blatant inconsistency of saying others could not do extraterritorially what we are free to do; if Congress intended to promote international beggar thy neighbor chaos of the type the proposed regulations would create, it should say so more plainly. I prefer to believe that Congress expected the Export Administration Act to be used moderately, consistent with conflict of laws principles.

Let me review some of the specific factors properly considered before U.S. export control or any other extraterritorial law is applied. First, if the foreign enterprises complied with U.S. law, they would violate, and perhaps as in the *Fruehauf* case, would be subject to criminal sanctions under foreign law. The concerned foreign governments also deplore the Soviet action in Poland. They have agreed to some joint political and legal measures to be taken in response. They have not agreed to block sales of non-military, non-strategic products for use in the West Siberian pipeline. They expect their companies to perform those sales.

The interest of the United States in having U.S. law applied to foreign firms is, essentially, a form of indirect economic retaliation against the Soviet Union. This interest is outweighed by the sovereign determination of our affected allies that it is in their long-term interests to have their firms help build the pipeline. We cannot presume to know better than, say, the French what is in the French interest.

Most tellingly, if serious economic retaliation against the Soviet Union were as crucial to us as, say, economic retaliation against Iran for the taking of American hostages, we would retaliate directly by stopping the sale of U.S. grain. At the time of the Iranian hostage crisis, when we imposed foreign controls to freeze dollar assets held abroad by the foreign branches of U.S. banks (a situation in which U.S. foreign policy interests were far more dramatically challenged) we did not seek to freeze dollar assets held by foreign banks even though transactions in those foreign dollars had to be cleared within United States territory.[11]

Additional factors to be weighed are: that the technology to be controlled is only one part of a foreign-made product to be sold from a foreign factory; that the technology was transferred years ago when it was legal to do so; that there is no pattern of evasion; that the parties to the license arrangement could not reasonably have anticipated this extraordinary assertion of U.S. jurisdiction to reach the foreign licensee; that Congress has not clearly authorized this assertion of jurisdiction; that this assertion of jurisdiction is incompatible with long-standing international custom and law; and that this application is virtually unenforceable without the undertaking of aggressive economic warfare on our most important allies whose assistance is essential if we are to resist and contain Soviet aggression.

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[11] Carswell, "Economic Sanctions and the Iran Experience," Foreign Affairs, p. 247 (Winter 1982/82).

As a concluding word, it may be appropriate for Congress to clarify the jurisdictional scope of U.S. export and foreign asset control laws so that, henceforth, Executive Branch officials will have more clearly in mind the proper limits of U.S. extraterritorial jurisdiction. The uncertainty of the legislative history of applicable legislation is used advantageously by those who would enforce U.S. laws excessively and destructively.

I testified just three months ago before the Senate Judiciary Committee[12] in support of expanding a proposed Presidential commission on the international application of existing U.S. antitrust laws (S. 432, sponsored by Senator Mathias). I stated then, and I repeat now, that excessive assertions of U.S. extraterritorial jurisdiction are becoming an increasingly serious problem undermining U.S. productivity and export opportunities, even where East-West trade is not involved.

The subject of today's testimony reinforces the notion that antitrust extraterritoriality is not the biggest part of the extraterritoriality problem and that the Congress, the Administration and the American people need to take a fresh look at the general question of extraterritorial jurisdiction. I hope today's hearing builds support for the establishment of such a commission.

Thank you.

Senator MATHIAS. Thank you very much, Mr. Rosenthal.

Let me begin with Mr. Marcuss. You remarked at the close of your statement that you felt that the issues that were at stake here really transcended the importance of the pipeline question itself and went to principles that were fundamental in considering the whole question of how Government controls business, how Government relates to business.

I would agree with that. It seems to me that this is an extremely important question, setting precedents as to how Government is going to reach out and control business. It is extraordinary that in a period of history in which there is a strong anti-regulatory trend and in which almost everyone in Congress has sworn in blood to help to deregulate, and in which one of the themes of the administration is deregulation, that we see this effort made to increase regulation and to do it in such an extraordinary way, that it is not only extraterritorial but that it is retroactive and imposes such extraordinary burdens on the private sector.

In your statement you said that the notion that foreign importers of U.S. goods and technology are subject to whatever subsequent restraints the United States may impose on their use would constitute a virtually limitless exercise of U.S. extraterritorial jurisdiction. Let me ask you to go on and say what you think the consequences of this virtually limitless exercise of U.S. extraterritorial jurisdiction would be.

That is a speculative question, but I think it is our duty to speculate a little bit.

Mr. MARCUSS. There are several possible consequences, Mr. Chairman, it seems to me. One certainly is that the certainty the business community needs in order to do business would be seriously impaired.

Second, the value of transactions would be difficult to calculate and difficult to predict.

Third is the possibility of retaliatory action by other countries: blocking statutes, orders to their own nationals not to obey U.S. law.

I suppose fourth, in a general sense, would be encouragement to the tendency in other countries that are deeply involved in their own business communities to use that tool, if you will, as an instrument of their foreign policy to an extent, to a larger extent than they have done in the past. We did not like the Arab oil embargo back in 1973 and 1974. We thought that was a politically motivated embargo and denounced it as such.

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[12] On behalf of the United States Chamber of Commerce.

Senator **Mathias.** I recall that words like "blackmail" were applied.

Mr. **Marcuss.** Yes, indeed.

It seems to me, apart from the problems of uncertainty and retaliation, that our responsibility, if we believe in a free enterprise system, is to encourage a system in which business can develop and flourish in an atmosphere of maximum possible certainty and in an atmosphere of maximum possible fair play and due process.

Ex post facto exercises of authority, whether extraterritorial or territorial, in a very significant way, it seems to me, undermine our basic long-term objectives.

Senator **Mathias.** Mr. Rosenthal, I particularly appreciated the fact that you brought into perspective this issue which has been curiously isolated from other similar issues. You brought it into perspective with the antitrust problem, with the banking and securities problem, with the other applications of extraterritoriality, some of which are inescapable in our modern system, but which have to be understood very carefully.

There is, as you may know, a meeting scheduled to take place at Ditchley Park in England about the middle of this month for a comprehensive review of this question by Europeans and Americans. I hope that they will give us the benefit of their consideration after that meeting, so that we can all benefit by it.

But what is clear, I think, from your assessment is if there is an attempt to apply extraterritoriality in cases that are too hard, that are obviously inappropriate, then it blunts the use of it in those other instances where in fact it is an appropriate exercise of national power. Is that a fair assessment?

Mr. **Rosenthal.** That is exactly right. I think we can contrast what we are talking about today with what I would consider to be a very hard case, the imposition of transaction controls at the time that the American hostages were taken in Tehran. It seems to me that that may well have been an appropriate response under an extraordinary provocation, which may not have risen to the level of national security but certainly involved a major incident of international terrorism, much closer to a state of war or a state of ultimate threat of national security than what we are talking about today.

One of the things that I would stress to you, Senator, is that we did essentially get the cooperation of our major allies in imposing those extraterritorial asset controls, even though they were all on record as strongly opposing such an extraterritorial application of law in principle, even though they were under tremendous pressure to undo, and even though suits were under way in their local courts to try to undo, the effect of our extraterritorial assertion of the blocking of the assets.

One of the reasons why they did cooperate with us and one of the reasons why this probably was an important part of the pressure which ultimately succeeded in the case of the hostages is that we applied those controls with moderation.

There is—and I commend to you; in fact, it might be worth reading into the record—an article in the recent issue of Foreign Affairs magazine by former Deputy Treasury Secretary Carswell reassessing the experience with the imposition of these economic sanctions in the Iranian foreign assets control case. One of the points he makes is the United States had the opportunity to assert U.S. law, if it had wanted to go all the way, over any foreign person holding dollars, trying to freeze all Iranian dollars held by foreign banks.

One could have used as a jurisdictional hook, as a maximalist jurisdictional hook, the fact that all Eurodollar transactions would ultimately be cleared through U.S. territory. And yet, the United States did not do that. They only reached part of the way to assert control over the branches on divisions of U.S. banks abroad, and in doing so they did not put themselves in a confrontational and oppositional relationship with our foreign banks and with the foreign governments. And it on the whole worked.

But I would add another point, Senator. As I think Mr. Carswell himself suggests, we have to reevaluate fundamentally whether, even if we can apply these laws under international law or properly under a balancing analysis, is this in fact the proper way we should be using our legal instruments.

Mr. Carswell does a review and notes adverse consequences to U.S. interests in part, as I believe, as a consequence of our freezing these Iranian assets under the control of U.S. banks and in part perhaps because the U.S. Government was unwilling or unable to go in and close down a private antitrust suit brought against the OPEC nations—and there was a period of time when it looked like the OPEC nations might be liable under U.S. law for treble damages—at a time they had $30 billion in demand deposits within U.S. banks subject to this kind of freezing action or attachment. Mr. Carswell finds that of the some $40 billion, if I remember correctly, he says which have been invested abroad by OPEC states since this period, almost none has been invested in U.S. banks.

Now, I do not know and Mr. Carswell said he does not know how important this extraterritorial freezing action was in the ultimate freeing of the hostages. We can certainly say that, because we are a democracy, because we do care about our people, because we do need to take strong action when we are provoked in such a way, it is understandable that we took that action. It is commendable that it was a measured response.

We cannot afford, though, the extravagances of outrage and indignation which really, it seems to me, are under consideration at this time, grossly disproportionate to the benefits that can be gained, grossly disproportionate to the proper use of legal instruments.

I would just like to add two other observations——

Senator MATHIAS. But let me interrupt you, if I may, because your concern over that episode is obviously mirrored by others. It is my understanding that there is now a study under way of the whole Iranian hostage problem and the legal response to it, undertaken jointly by the Bar Association in New York and the Council on Foreign Relations, being conducted by a very distinguished former Member of the Senate, Senator Abraham Ribicoff. It should be a fascinating study when it is completed. I would hope it would touch upon the very question that you raise here.

Mr. **Rosenthal.** I did not know that. I think that can be a very important and worthwhile project.

The two points I want to add are these: We are indignant when our neighbor to the north, for example, Canada, establishes a foreign investment review board and expresses serious concern about the impact of U.S. industry and investment in Canada and tries to limit that. I urge the members of this committee and the public at large to keep in mind the Canadian response and the response of others when they see these excessive extraterritorial jurisdictions.

What would we in the United States do? Let me remind you that a number of your colleagues at the time the Arab States became important investors in the United States were calling for a foreign investment review board in the United States to limit Arab investments here. Why were they doing it? Because they were concerned about the extraterritorial application of the Arab boycott.

We are a country significantly larger, many times larger than Canada, significantly larger than France, significantly larger than Italy, if we want open investment in these countries, how can we push these extraterritorial regulations so aggressively?

Senator **Mathias.** Again, let me interrupt you to say that a week from today, next Wednesday, this committee will look into the question of economic relations between the United States and Canada, with some of the concerns that you have mentioned.

Mr. **Rosenthal.** I think it is a terribly important problem. It is a problem which the other speakers this morning and which you and Senator Percy have alluded to. We are not talking here about dealing with some nations that are borderline enemies of the United States, which cannot be relied upon.

What are the nations we are talking about dealing with today if these regulations are imposed? England, West Germany, Italy, France. These are the nations which, with us, the free world is depending upon. And Canada, in a different context. The free world is depending upon them to maintain a strong resistance to Soviet aggression around the world. As Senator Percy said, by taking this track we are seriously jeopardizing our vital interests, and seriously aiming a gun at our foot.

The other observation that I would make is this. I think one of the consequences of this kind of excessive extraterritorial assertion is, as my hypothetical with France indicated, we may begin to teach our foreign allies that there is something to an aggressive extraterritorial posture on their own part. I take an example which your friend Lloyd Cutler gives because he is involved in the litigation, the current investigation by the European Common Market of IBM Corp. and the possibility that under Common Market antitrust law the Common Market will seek to have IBM divest proprietary information which will give a dramatic competitive advantage to Japanese computer firms, European computer firms, and others in competition with IBM.

When this is happening to a major American exporter of technology and a major American exporter of products on whom our economy significantly depends, we are concerned about this extraterritorial relief provision. Yet in fact, as a matter of extraterritoriality the Europeans do have a territorial basis for which to seek this relief, and we do not like it when now finally, under the encouragement of prior U.S. actions—and make no mistake about it, the European Common Market antitrust authorities have sat at the feet of American antitrust authorities and learned about aggressive extraterritorial assertions from us—they are now seeking to apply their laws against American firms.

That is one of the consequences as well, it seems to me.

Mr. MARCUSS. It occurs to me, Mr. Chairman, as Mr. Rosenthal speaks that it is ironic. In some ways we have been putting a great deal of pressure on the Japanese to open up their markets to U.S. exports and to U.S. investment. One might question how a Japanese company approached by an American company today with an offer for sale of technology, parts or components of equipment might react if he were to contemplate the possibility that he might not be able to utilize that technology or the equipment and so forth because the United States some day might impose controls.

There is an interesting asymmetry there, if you will, in our thinking.

Senator MATHIAS. It is not only an asymmetry in our thinking, but an uncertainty in our ability to plan ahead.

There is a lot of talk in Congress today about the principle of reciprocity, about our ability to control trade issues on the basis of reciprocity. Of course, what both of you have said here is that we ought to bear that in mind, with respect to this question, that it can be a reciprocal question.

How serious do you think the collision could be? Mr. Rosenthal, you really have expressed your view on that. Mr. Marcuss, do you think the collision would be very serious? Suppose we get reciprocity on this issue. Suppose we get just what we have been asking for. What consequences do you see?

Mr. MARCUSS. Well, what is sauce for the goose is sauce for the gander, or whatever the phrase is. I always forget it. I never seem to get it right.

It seems to me the time at which we could disregard the economic interests of other nations is long past, and other nations now know that. I think they will rightly insist that we act toward them just as we seek to have them respond to us.

If we are to embrace the broad principle of reciprocity—and it is very difficult in its detailed application—it seems to me that we have to be prepared as a matter of principle to accept retaliatory measures from other countries, which they will increasingly be in a position to enforce. I think perhaps the best, most clear, example of the trend of the ability of foreign countries to enforce their interests is the increasing investment of foreign funds in the United States. From an economic point of view, that is to be welcomed. But I think we have to recognize that as a consequence other countries would be in a position to dictate the activities of economic enterprise in this country to a far larger extent than they have in the past.

If we fail to establish a principle of neutrality in that regard, it seems to me the chickens could very easily come home to roost.

Senator MATHIAS. One possible assertion of extraterritoriality would be that involving the General Electric rotors, which as I understand it were shipped to Great Britain in 1978 and were built into compressors that were completed prior to the imposition of sanctions in December of last year.

Now, we have raised the question of retroactivity here. What is your judgment on these preexisting contracts? Can they reach back in time as well as out in space?

Mr. **Marcuss**. One needs to know what the particular contractual arrangement is between the U.S. exporter and the foreign importer. But I will make two observations.

One, let us assume they were exported under a general license and that as a consequence there were no restrictions on the use to which the British could put those parts. The United States has no jurisdiction per se over the foreign importer. Its jurisdiction is over the U.S. exporter who shipped under a general license.

I find it a little difficult to visualize what the Commerce Department might do. Would it contact General Electric and say: By the way, several years ago you shipped something under a general license. Well, we are now revising your general license. General Electric might very well say: That is very nice, thank you. But what do you expect us to do?

Alternatively, the shipment may have been under a validated license, and it is possible that the foreign importer made a commitment pursuant to that validated license, although it is unlikely, but it is conceivable, a commitment that it would abide by any subsequent U.S. export regulations. In that circumstance, it seems to me it may have subjected itself for that limited purpose to jurisdiction of the United States and have obligated itself to comply with U.S. export control laws.

It would be a limited form of jurisdiction and of limited purpose, but nonetheless it might very well exist. Could it be enforced? Well, there are several possible angles. One, under export administration procedures generally, if a foreign company exports in violation of a U.S. export restriction it can be placed on a blacklist so that no U.S. exporter can make future shipments to that company. Another possibility, as has been suggested in other contexts, is an arrest, as an extreme course against the foreign importer.

So one would really need to know the specific facts of those transactions. It may or may not be possible to reach back. But the reaching back would be of a very limited sort, and it might be as a practical matter somewhat difficult to enforce.

Senator **Mathias**. Perhaps before I close this hearing I should state for the record that the Department of State was invited to appear here and testify today, but it chose not to do so. The record will be available to them if they wish to make a statement within a reasonable period of time.

I was somewhat amused by Mr. Rosenthal's statement, No. 1, that some lawyers in the administration do not believe that there is a sufficient legal basis to apply export controls to the European contracts. But then he goes on to say that we are unlikely to learn the basis for their views unless and until their view prevails. Of course, that is one of the unhappy aspects of the fact that we do not have an administration statement today.

I do not know that you wish to appear unduly cynical, but I would assume from that statement and from your own previous experience in two administrations that legal opinions in the executive branch are very often shaped to conform to the policy position that already has been adopted, and therefore perhaps the absence of a statement at this point in the proceedings is an indication that a policy has not yet been fully matured and ready to be delivered. Would you say that is true, Mr. Rosenthal?

Mr. ROSENTHAL. Yes; but I would say there is an opportunity, and an opportunity which from time to time one did have a chance to exercise, where policy was affected and where policy can be affected by legal considerations. I do think that with some in this administration, if there are serious legal problems with applying the sanctions that are under consideration, that will have weight.

I would certainly hope that in the future we develop a concern with the legal implications of political policies. I think the example I gave to you in the prior administration with respect to the freezing of Iranian assets is an example where legal considerations did play a part. The lesson I draw from the fact that legal considerations played a part in the foreign asset controls that were applied in the Iranian hostage case is that the legal considerations helped to make it a better policy.

Law and policy are not necessarily going off in two different directions. They can be and should be mutually reinforcing. But the view that you stated, Mr. Chairman, is unfortunately the widely held view, that law is largely irrelevant, it is there to paper over what you decide to do for policy reasons. I cannot think of any subject, any series of illustrations other than the ones we have ticked off in this morning's hearings, which better indicate how sterile and what a profound mistake that view of the interplay between law and policy is.

Senator MATHIAS. This is a good point to close this hearing, because we have had the benefit of your testimony, enlightened testimony which is based not only upon your legal knowledge but upon practical experience. It should be extremely helpful to those in the administration who are charged with the responsibility for making these decisions. If it is, then I think we have all spent our morning well, and I hope it will be. I will take all the steps that I can to make sure that it is available.

We are grateful to both of you for being here, and to Mr. Downey and Mr. Chapman. I think it has been a highly educational morning so far as the committee is concerned. Thank you very much.

Mr. ROSENTHAL. Thnak you, Mr. Chairman.

Mr. MARCUSS. Thank you, Senator.

Senator MATHIAS. This subcommittee will stand adjourned.

[Whereupon, at 12:30 p.m., the subcommittee adjourned, subject to call of the Chair.]

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